

Corporations and Markets **Advisory**  
**Committee**

**The AGM and shareholder  
engagement**

**Discussion paper**  
**[with all updates in track-changes]**

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## Contents

<b>1</b>	<b>Introduction .....</b>	<b>1</b>
1.1	Reference to CAMAC .....	1
1.2	Structure of the paper .....	2
1.3	Request for submissions .....	3
1.4	Advisory Committee.....	4
<b>2</b>	<b>Issues for consideration .....</b>	<b>7</b>
2.1	Overview .....	7
2.2	Issue 1: Shareholder engagement .....	7
2.3	Issue 2: The annual report.....	11
2.4	Issue 3: The AGM .....	12
<b>3</b>	<b>Shareholder engagement .....</b>	<b>17</b>
3.1	Approaches in Australia .....	17
3.2	Approaches in the United Kingdom .....	28
3.3	Other international initiatives .....	<a href="#">373734</a>
3.4	Questions for consideration .....	<a href="#">515045</a>
<b>4</b>	<b>The annual report .....</b>	<b><a href="#">535147</a></b>
4.1	Approaches in Australia .....	<a href="#">535147</a>
4.2	Approaches in the United Kingdom .....	<a href="#">615953</a>
4.3	United States.....	<a href="#">706861</a>
4.4	Questions for consideration .....	<a href="#">716962</a>
<b>5</b>	<b>Conducting the AGM.....</b>	<b><a href="#">737163</a></b>
5.1	Ambit of the chapter .....	<a href="#">737163</a>
5.2	Regulatory overview.....	<a href="#">737163</a>
5.3	Calling the AGM .....	<a href="#">757365</a>
5.4	Shareholders placing matters on the AGM agenda .....	<a href="#">797767</a>
5.5	Questions from shareholders prior to the AGM .....	<a href="#">848273</a>
5.6	Business of the AGM .....	<a href="#">868475</a>
5.7	Chairing the AGM.....	<a href="#">878576</a>
5.8	Proxy voting .....	<a href="#">939182</a>
5.9	Direct voting before the meeting .....	<a href="#">1019989</a>
5.10	Disclosure of pre-meeting voting .....	<a href="#">10310191</a>
5.11	Online voting during the AGM.....	<a href="#">10610494</a>
5.12	Exclusions from voting.....	<a href="#">10710595</a>
5.13	Voting by show of hands .....	<a href="#">10810696</a>
5.14	Independent verification of votes cast on a poll .....	<a href="#">11010897</a>

---

5.15	Disclosure of voting after the AGM .....	<a href="#">11211099</a>
5.16	Election of directors .....	<a href="#">114112101</a>
5.17	Dual listed companies .....	<a href="#">118116104</a>
5.18	Globalisation .....	<a href="#">119117105</a>
<b>6</b>	<b>Future of the AGM .....</b>	<b><a href="#">121119107</a></b>
6.1	Overview .....	<a href="#">121119107</a>
6.2	Functions of the AGM .....	<a href="#">121119107</a>
6.3	Format of the AGM .....	<a href="#">126125113</a>

# 1 Introduction

*This chapter sets out the terms of reference on the future of the annual general meeting, outlines the structure of the paper, and invites submissions on any aspect of the reference.*

## 1.1 Reference to CAMAC

By letter of 5 December 2011, the then Parliamentary Secretary to the Treasurer, the Hon. David Bradbury MP (the PST), requested CAMAC to consider a number of matters concerning the annual general meeting (AGM).

By way of background, the PST observed in the letter that:

Annual general meetings (AGMs) have in the past provided a forum for, amongst other things, the reporting of significant company information (such as the annual results), the passage of significant shareholder resolutions, and the scrutiny of company directors.

With improvements in technology, which has resulted in continuous real-time dissemination of company information, and the introduction of the two-strikes test, it is timely to assess the role of the AGM as part of broader shareholder engagement.

The AGM provides a forum for shareholder participation in the process of director accountability and engagement by retail shareholders towards scrutiny of company management. The Government would like to ensure that the AGM remains responsive to the needs of shareholders and stakeholders in the company, and continues to serve its intended purposes, including providing a valuable forum to facilitate effective corporate governance.

The importance of foreign capital to the Australian economy is well recognised. With the globalisation of financial markets, foreign share ownership and dual-listing have become more common. Fitting the AGM into this setting while retaining its usefulness will continue to be a challenge in the future, as the physical meeting becomes more difficult to participate in for an increasing number of stakeholders. In particular, issues of director scrutiny and participation in voting for shareholders who, due to the globalisation of capital markets, find it increasingly difficult to attend AGMs, will continue to present challenges.

In the context of a report on shareholder participation in the governance of companies, the Parliamentary Joint Committee of Corporations and Financial Services (PJC) gave some consideration to the role of the AGM. The focus of this report, however, was on the participation and engagement of shareholders more generally, rather than a detailed consideration of the requirements regarding AGMs. Amongst other things, this report (which is still listed as being under consideration) recommended that ASIC establish best practice guidelines for AGMs but, in the context of its overall review of shareholder participation issues, did not recommend significant changes to the role or conduct of the AGM.

The PJC report also identified issues relating to the usefulness of the annual report document, including a lack of shareholder engagement with or comprehension of the document. The report mentions the potential for interactive electronic documents to increase accessibility to this generally dense document to retail investors, but stops short of making recommendations to specifically bring this about.

The PST then requested that CAMAC inform the Government on:

- the future of the annual general meeting in Australia, including how documents and meeting forms should change to meet the needs of shareholders in the future
- the risks and opportunities presented by advancements in technology, in the context of maintaining the ongoing relevance and efficacy of the AGM
- the challenges posed to the structure of the AGM by globalisation, including potential increases in international share ownership and dual-listing.

## 1.2 Structure of the paper

### 1.2.1 Companies covered

All public companies must hold an AGM. These companies can take the form of companies limited by shares and/or guarantee. Companies limited by shares may be listed or unlisted. Companies limited by guarantee may be charitable or other not-for-profit (NFP) entities.

This paper does not seek comment on the AGM or annual reporting requirements of NFP entities. The Government will undertake a separate consultation process on these matters as part of reforms to establish a national regulator for the NFP sector, the Australian Charities and Not-for-profits Commission (ACNC). The Government has introduced into Parliament draft legislation to implement a national regulatory framework for NFPs,<sup>1</sup> and is currently developing regulations that will set out governance, meeting and annual reporting requirements tailored for all NFP entities registered with the ACNC. In the case of NFP entities that are established as companies, the ACNC governance, meeting and annual reporting requirements will replace equivalent requirements contained in the *Corporations Act 2001*. The Government will consult on the ACNC regulations, including these requirements, as part of a separate public consultation process that will commence shortly.

Various other corporations are also separately regulated and therefore are outside the ambit of this paper.<sup>2</sup>

Given this, and for ease of analysis, references to companies in this paper will generally mean listed companies, limited by shares.

### 1.2.2 Issues covered

This paper considers the AGM in the context of the ongoing interrelationship between a company and its shareholders.

As explained in Section 2.1, CAMAC identifies for review three general areas affecting that interrelationship:

- shareholder engagement

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<sup>1</sup> See, for instance, the Australian Charities and Not-for-profits Commission Bill 2012.

<sup>2</sup> The *Corporations (Aboriginal and Torres Strait Islander) Act 2006* (Cth) establishes Indigenous corporations under the regulation of the Office of the Registrar of Indigenous Corporations. That Act contains provisions in relation to AGMs etc. Also, the States are proceeding to introduce national laws in relations to co-operatives, with NSW recently introducing the *Co-operatives (Adoption of National Law) Act 2012* (NSW), with other States to follow. That Act also has AGM etc requirements.

- the annual report
- the AGM.

### ***Shareholder engagement***

An overview of matters concerning shareholder engagement is set out in Section 2.2, with Chapter 3 providing contextual information and analysis from Australia and elsewhere.

Questions concerning shareholder engagement, on which submissions are invited, are set out at the end of Chapter 3.

### ***The annual report***

An overview of matters concerning the annual report is set out in Section 2.3, with Chapter 4 providing contextual information and analysis from Australia and elsewhere.

Questions concerning the annual report, on which submissions are invited, are set out at the end of Chapter 4.

### ***The AGM***

An overview of the current functions and procedures for conducting an AGM is set out in Section 2.4.2. Chapter 5 analyses the current regulatory framework for conducting an AGM, and raises questions throughout that chapter on which submissions are invited.

An overview of matters concerning the future of the AGM is set out in Section 2.4.3. Chapter 6 considers possible future functions and formats of an AGM, and raises questions throughout that chapter on which submissions are invited.

## **1.2.3 References to the CASAC Report**

References in this paper to the CASAC Report refer to the Companies and Securities Advisory Committee Report *Shareholder Participation in the Modern Listed Public Company* (June 2000), available under Publications (then go to Reports) on the CAMAC website: [www.camac.gov.au](http://www.camac.gov.au)

In 2002, the name was changed from CASAC to CAMAC.

## **1.3 Request for submissions**

CAMAC invites submissions on any aspect of the terms of reference, including the three general issues discussed in Chapter 2 of this paper and the questions raised under each of those issues in subsequent chapters of this paper.

In preparing submissions, respondents are invited to draw distinctions between different types of public companies, or within a category of public company (for instance between large and small listed public companies), if and where considered appropriate.

However, as explained elsewhere, this review:

- does not include not-for-profit (NFP) entities, which are subject to an ongoing legislative review process<sup>3</sup>

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<sup>3</sup> See Section 1.2.1.

- does not include the provisions for voting on the remuneration report, the two-strikes rule, and the ‘no vacancy’ provisions concerning board positions. These matters involve recent policy decisions by the Government, which this paper does not seek to reopen.<sup>4</sup>

Please email your submission, **in Word format** (not pdf), to:

[john.kluver@camac.gov.au](mailto:john.kluver@camac.gov.au)

with a cc to:

[camac@camac.gov.au](mailto:camac@camac.gov.au)

Word format is requested, as part of the internal CAMAC process for considering submissions involves their collation under topic headings.

All submissions, unless marked confidential, will be published at [www.camac.gov.au](http://www.camac.gov.au). Submissions will be published in pdf format.

Please forward your submissions by the evening of **Friday 21 December 2012**.

If you have any queries, you can call (02) 9911 2950.

CAMAC also anticipates holding a roundtable in 2013 with major stakeholder groups.

## 1.4 Advisory Committee

CAMAC is constituted under the *Australian Securities and Investments Commission Act 2001*. Its functions include, on its own initiative or when requested by the Minister, to provide advice to the Minister about corporations and financial services law and practice.

The members of CAMAC are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The members of CAMAC are:

- Joanne Rees (Convenor)—Chief Executive Officer, Allygroup, Sydney
- David Gomez—Principal, Merit Partners, Darwin
- Jane McAloon—Group Company Secretary, BHP Billiton Limited, Melbourne
- Alice McCleary—Company Director, Adelaide
- Denise McComish—Partner, KPMG, Perth
- Marian Micalizzi—Chartered Accountant, Brisbane
- Michael Murray—Legal Director, Insolvency Practitioners Association, Sydney

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<sup>4</sup> See Section 5.1.

- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- John Price—Commissioner, Australian Securities and Investments Commission (nominee of the ASIC Chairman)
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler AM—Consultant, Ashurst Australia, Sydney
- Greg Vickery AM—Special Counsel, Norton Rose Australia, Brisbane.

A Legal Committee has been constituted to provide expert legal analysis, assessment and advice to CAMAC in relation to such matters as are referred to it by CAMAC.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee are:

- Greg Vickery AM (Convenor)—Special Counsel, Norton Rose Australia, Brisbane
- Rosey Batt—Principal, Rosey Batt and Associates, Adelaide
- Lyn Bennett—Partner, Hunt & Hunt, Darwin
- Elizabeth Boros—Barrister-at-Law, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Jennifer Hill—Professor of Law, University of Sydney
- James Marshall—Partner, Ashurst Australia, Sydney
- David Proudman—Partner, Johnson Winter & Slattery, Adelaide
- Brian Salter—General Counsel, AMP, Sydney
- Rachel Webber—Special Counsel, Jackson McDonald, Perth.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thamani Parrino—Office Manager.



## 2 Issues for consideration

*This chapter outlines three key overarching issues arising from the reference to CAMAC and refers to subsequent chapters where these matters are further considered.*

### 2.1 Overview

In responding to the reference from the PST, CAMAC notes the desire of the Government:

to ensure that the AGM remains responsive to the needs of shareholders and stakeholders in the company, and continues to serve its intended purposes, including providing a valuable forum to facilitate effective corporate governance.

The Committee has identified three overarching issues, consideration of which is central to the continuing corporate governance role of the AGM:

- the role of the AGM within the broader context of the ongoing relationship between the board and the institutional and retail shareholders of the company, often referred to as shareholder engagement
- the content of the annual report, being the principal document for consideration at the AGM that provides information to shareholders on the state of the company and the stewardship of the board
- the current processes, and possible future functions and formats, of the AGM.

Key aspects of each of these matters are set out below. Subsequent chapters provide more detailed contextual information, and set out questions on which submissions are invited.

### 2.2 Issue 1: Shareholder engagement

#### 2.2.1 Terms of reference

The reference to CAMAC raises the general question of the future of the AGM in Australia. In setting this context for the CAMAC review, the PST letter noted that:

it is timely to assess the role of the AGM as part of broader shareholder engagement.

In general terms, shareholder engagement refers to the ongoing structured and informal interaction of institutional and retail shareholders with the company throughout the year, as well as in the period leading up to, and at, the AGM.

#### 2.2.2 Company-shareholder relationship

Shareholder engagement takes place in the context of the legal relationship between a company and its shareholders. The general principle adopted in common law jurisdictions is that the board of directors is the primary corporate decision-making body. Unless otherwise specified in a company's constitution, the conduct of the business of the company is to be managed by the board of directors, which has broad powers to initiate and adopt

corporate plans, commitments and actions.<sup>5</sup> In fulfilling that function, the board typically delegates significant authority for the day-to-day operations of the company to the chief executive officer (CEO) and other corporate officers. In general, shareholders cannot give directions to the board, through the AGM or otherwise, as to the exercise of its management powers.<sup>6</sup>

The rationale for this central role of the board in the management of the company is summed up in the *OECD Principles of Corporate Governance*:

As a practical matter ... the corporation cannot be managed by shareholder referendum ... Moreover, the corporation's management must be able to take business decisions rapidly. In light of these realities and the complexity of managing the corporation's affairs in fast moving and ever changing markets, shareholders are not expected to assume responsibility for managing corporate activities.

Shareholders have a more restricted role. Except where shareholders are given a decision-making function by the constitution of the company, by legislation<sup>7</sup> or by exchange rules,<sup>8</sup> they have a more limited capacity to influence the business and affairs of the company. They have various information rights and the right to participate in the AGM or other shareholder meetings. Shareholders who satisfy a statutory threshold may initiate an extraordinary general meeting.<sup>9</sup> They may also propose or vote on resolutions within their powers. In certain circumstances they may initiate derivative proceedings on behalf of a company.<sup>10</sup>

The limitations on the rights of shareholders in the corporate decision-making process are offset by limitations on their obligations. Unlike directors, shareholders, in that capacity, owe no fiduciary or other duties to the company.<sup>11</sup> Nor do shareholders owe comparable fiduciary duties to their fellow shareholders, though the equitable notion of fraud on the minority and the statutory oppression remedy<sup>12</sup> do provide a limit on the powers of a majority of shareholders to act in their own self-interest at the expense of the minority. Shareholders may have dissimilar, even conflicting, interests, including in regard to their investment strategies and goals and their investment time horizons. In pursuing their particular financial and other goals, shareholders can act in their own self-interest (subject

<sup>5</sup> Section 198A of the Corporations Act (a replaceable rule) provides that the business of a company is to be managed by or under the direction of the directors.

<sup>6</sup> For instance, in *NRMA v Parker* (1986) 4 ACLC 609 at 614, the Court stated that:

It is no part of the function of the members of a company in general meeting by resolution, i.e. as a formal act of the company, to express an opinion as to how a power vested by the constitution of the company in some other body or person ought to be exercised by that other body or person.

<sup>7</sup> The Corporations Act sets out various circumstances where corporate action depends on shareholder approval, including various transactions affecting share capital (Chapter 2J), corporate restructuring through a members' scheme of arrangement (Part 5.1) and related party transactions (Part 2E).

<sup>8</sup> For instance, ASX Listing Rule 10.1 requires listed entities to obtain the approval of holders of their ordinary securities for any acquisition of a substantial asset from, or disposal of a substantial asset to, certain related entities. ss 249D-249F.

<sup>9</sup> Part 2F.1A permits shareholders or others in certain circumstances to initiate proceedings on behalf of a company. See, for instance, *In the Matter of Rus Holdings (Australia) Pty Ltd* [2012] NSWSC 1075. The elements of the remedy concerning (i) whether there is a serious question to be tried, (ii) whether the applicant is acting in good faith and (iii) whether it is in the best interests of the company to grant leave to the applicant, are discussed in *Re The President's Club Ltd* [2012] QSC 364 at [39] ff. In *Ragless v Ipa Holdings Pty Ltd (in liq) and Carnie (Non Party)* [2012] SASC 203, at [55] ff, the Court considered the issue of personal animus in commencing derivative proceedings. In regard to costs, see, for instance, *Links Golf Tasmania Pty Ltd v Sattler (No 2)* [2012] FCA 1271.

<sup>11</sup> In some circumstances, a larger shareholder may also be a director of the company even though not formally appointed to the board. Under the s 9 definition of 'director', a person is a director if 'the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes'.

<sup>12</sup> s 232.

to the foregoing limitations), even if this differs from the goals of the company or other investors.

Shareholders may differ as to the degree of influence they wish to exert with the board and management of the company. In some circumstances a shareholder that seeks to exercise a high degree of influence may be deemed to be a director of the company, even though not formally so appointed.<sup>13</sup>

Another significant factor is the increasing rate of turnover of shares in the market, with the average period of owning shares in a listed company steadily declining over recent years, exacerbated by the increasing use of high-speed electronic trading.

This diversity of shareholder interests, expectations and time-frames for holding shares, can present significant challenges for boards of directors, including how to tailor their way of dealing with different shareholders throughout the year, not just at the AGM. Poor communication between a company and particular shareholders may create or exacerbate unnecessary problems or misunderstandings between them. Enhanced engagement may assist the communication process, help avert or resolve misplaced investor concerns that otherwise may dominate or distract proceedings at an AGM, or deepen the understanding of the board and shareholders of each other's perspectives.

Typically, only a small fraction of shareholders attend an AGM, though many absent shareholders may have voted by way of proxy prior to the meeting. It could be argued that the decision of many shareholders not to attend the AGM reinforces the importance of shareholder engagement being ongoing, not just immediately prior to or at the AGM itself. This continuing engagement may assist and encourage more informed involvement by shareholders in matters pertaining to the company in which they have invested, with the AGM remaining as one means for shareholders to hold the board publicly accountable.

Engagement, however, may not necessarily result in a conjunction of interests or perspectives between a company and its various shareholders, or between shareholders. Each shareholder will still form judgments on the management of the company and the wisdom of holding its equity. Some shareholders may seek change in the company through formal means (such as initiating an extraordinary general meeting or proposing resolutions at an AGM to remove one or more directors), liquidate their equity investment, or even turn to litigation against the company or its directors. The shareholder engagement process may in some instances have averted these outcomes; in other instances it may have led to them.

### 2.2.3 Aspects of engagement

#### *Role of the board*

Traditionally, the board has been seen as the entity with principal responsibility for encouraging and advancing institutional and retail shareholder engagement. This is reflected, for instance, in the approach adopted in the ASX Corporate Governance Council *Corporate Governance Principles and Recommendations with 2010 Amendments* (ASX Corporate Governance Council *Principles and Recommendations*) and in industry guidance to directors on how best to engage with shareholders.<sup>14</sup>

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<sup>13</sup> The definition of 'director' in s 9 includes a 'shadow director', being any person who is not formally appointed as a director but who acts in the position of a director (see further *Grimaldi v Chameleon Mining NL (No 2)* [2012] FCAFC 6 at [64]-[69]) or where 'the directors of the company or body are accustomed to act in accordance with the person's instructions or wishes'.

<sup>14</sup> See, for instance, J Stafford, *Engaging with shareholders* (AICD) 2011.

In practice, the quality of a board's engagement with shareholders may depend to a considerable degree on the efforts of individual board members, particularly the board chair and chairs of board committees, to keep in touch with shareholder views and concerns. Ideally, companies should have a proactive engagement plan to ensure satisfactory ongoing dialogue with shareholders, including contact initiatives by the chair and other specified board members, to be overseen by the board. The engagement plan could continue to be adjusted to identify:

- *dialogue areas*: for instance, matters concerning corporate strategy and key business opportunities, corporate governance, board composition and director appointments as well as executive remuneration
- *dialogue processes*: including various forms of face-to-face contact as well as written communications, and
- *dialogue responsibilities*: being allocated to specified board members, or the board collectively, depending upon the dialogue area.

Utilising an engagement plan would be consistent with the recommendation in the ASX Corporate Governance Council *Principles and Recommendations* that companies should design a communications policy for promoting effective communication with shareholders.<sup>15</sup>

Another possible avenue of shareholder engagement is for the board to initiate informal 'town hall' meetings, to brief retail shareholders, in particular, on matters affecting the company and provide them with the opportunity to ask questions and express views on matters of interest or concern to them. Such informal meetings do not allow participating shareholders to pass formal resolutions, but are a means to assist communication and understanding between the company and its equity investors. These meetings may also influence the views of shareholders concerning participation at the AGM.

### ***Role of institutional shareholders***

Attention has also been given in various jurisdictions, including the United Kingdom, to the role of institutional shareholders in this engagement process. The *UK Stewardship Code* sets out principles and guidance on how various institutional shareholders might best discharge their responsibility as significant owners of equity in the company, including reporting on how they influence or oversee how a company is managed.

### ***Role of proxy advisers***

In consequence of various legislative requirements, AGMs are concentrated into a relatively short period in the later part of each year. This can affect how institutional shareholders organize their AGM share voting activities, including the extent to which they outsource research on matters for consideration at the AGM to service providers, for cost and efficiency reasons. This brings into focus the role of proxy advisers in the engagement process and their level of influence on institutional share voting at AGMs.

There are differing views about the appropriate use that institutional shareholders should make of these advisers. Questions have been raised about the degree to which institutional shareholders should be entitled to rely on the advice of proxy advisers in making voting decisions, or, whether those shareholders should have some obligation to bring an independent mind to bear on these matters. Questions have also been raised about the

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<sup>15</sup> Recommendation 6.1.

possible need for regulatory or other mechanisms to deal with conflict of interest and transparency issues concerning the advisers.

#### **2.2.4 Further analysis and questions**

Matters involving shareholder engagement are further discussed in Chapter 3, which provides information and developments in Australia and elsewhere. These matters include the right of 100 members to call an extraordinary general meeting of shareholders.

Questions concerning shareholder engagement, on which submissions are invited, are set out at the end of Chapter 3 (Section 3.4).

### **2.3 Issue 2: The annual report**

#### **2.3.1 Terms of reference**

The terms of reference raise the question whether documents provided for the AGM should change to meet the needs of shareholders in the future.

#### **2.3.2 Rethinking the annual report**

The principal document prepared for the information of shareholders at the AGM is the annual report. In addition to any public announcements, including under the continuous disclosure requirements, the annual report may be the principal source of information on the affairs and direction of the company, particularly for retail shareholders who rarely have the level of ongoing informal access to the company often available to institutional shareholders.

The content of the annual report is closely regulated in Australia, with detailed disclosure requirements supplemented by more general obligations to disclose information concerning the overall performance and prospects of the company. However, concerns have been raised about the level of complexity of some reports, with calls to reform or rationalise the requirements to ensure that reports contain the type of information that investors desire, in a form accessible and comprehensible to retail, as well as institutional, shareholders.

There have been industry initiatives to provide guidance on the structuring of annual reports, with a view to increasing their utility, particularly for retail shareholders. Matters relating to financial and other aspects of reporting are also being considered by the Financial Reporting Council. In addition, ASIC proposes shortly to publish draft guidance to assist directors of listed entities to prepare the operating and financial review of the annual report.

Attention has been given in the UK in recent years to various matters concerning the content and method of presentation of annual reports, including:

- whether annual reports contain unnecessary information (‘clutter’) that impedes their utility for shareholders, and how it might be removed
- whether the current directors’ report should be replaced by a Strategic Report and an Annual Directors’ Statement. In the Strategic Report, the board would be required to set out the strategy and direction of the company, as well as the challenges facing it, together with supporting high-level financial and other information. The Annual Directors’ Statement would provide more detailed, comparable information for analysts and others to use

- whether the necessary information in annual reports could be presented better and in a manner that employs technological developments, such as the use of XBRL ([which stands for eXtensible Business Reporting Language](#), a technological means of communicating business information<sup>16</sup>), to increase accessibility to components of those reports
- whether a ‘Financial Reporting Laboratory’ system should be developed for companies to test possible new reporting formats with investors.

### 2.3.3 Further analysis and questions

Matters involving the annual report are further discussed in Chapter 4, which provides information and developments in Australia and elsewhere.

Questions concerning shareholder engagement, on which submissions are invited, are set out at the end of Chapter 4 (Section 4.4).

## 2.4 Issue 3: The AGM

### 2.4.1 Terms of reference

The terms of reference raise matters concerning the conduct of the AGM, including:

- how meeting forms for AGMs should change to meet the needs of shareholders in the future
- the risks and opportunities presented by advancements in technology, in the context of maintaining the ongoing relevance and efficacy of the AGM
- the challenges posed to the structure of the AGM by globalisation, including potential increases in international share ownership and dual-listing.

This paper considers these matters in the broader context of the current and future role of the AGM as a corporate governance and management accountability mechanism.

### 2.4.2 Current functions and format

#### *Functions of the AGM*

All public companies must hold an AGM.<sup>17</sup> The AGM serves various purposes in the general engagement process between companies and shareholders and is a mechanism for accountability of those in control of the company to the owners. The AGM is a forum for:

- *reporting*: to inform shareholders about various financial and other matters concerning the company, principally through consideration of the annual report<sup>18</sup>

<sup>16</sup> A useful explanation of XBRL and iXBRL is set out in Attachment 2 of the Australian Government *Options paper: use of standard business reporting (SBR) for financial reports* (November 2012). This paper canvasses various options for the use of this technology for the lodgement of financial reports: see further Section 4.1.4 of this CAMAC paper under *Australian Government*.

<sup>17</sup> Each public company must hold an AGM at least once in each calendar year, and within 5 months after the end of its financial year: s 250N. ASIC has the power to grant an extension of time: s 250P.

<sup>18</sup> s 317.

- *questioning*: to provide an opportunity for shareholders to ask questions or make comments on various matters, including the management of the company, the remuneration of directors and other senior corporate officers and the conduct of the company's audit<sup>19</sup>
- *deliberating*: to provide an opportunity for shareholders to discuss the matters on which they will be called to vote at the meeting
- *decision making*: to enable shareholders to vote (through binding or non-binding resolutions) on a limited range of matters at the AGM, including:
  - the remuneration report (which constitutes part of the directors' report in the annual report)<sup>20</sup>
  - the annual financial report, directors' report and auditor's report<sup>21</sup>
  - the election of directors<sup>22</sup>
  - the appointment of the auditor and the fixing of the auditor's remuneration<sup>23</sup>
  - other permissible resolutions concerning the company that may also conveniently be considered at the AGM, such as resolutions to amend the company's constitution,<sup>24</sup> adjust the share capital in some manner,<sup>25</sup> or remove one or more directors.<sup>26</sup>

Beyond that, shareholders, at the AGM or otherwise, cannot direct the board in the exercise of its powers.

### **Format of the AGM**

The AGM must be held at 'a reasonable time and place'.<sup>27</sup>

Companies may use technology to hold an AGM or other shareholder meeting at more than one venue, provided that shareholders as a whole have a reasonable opportunity to participate in the meeting.<sup>28</sup> According to the explanatory memorandum for the relevant provision:

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<sup>19</sup> ss 250PA-250T.

<sup>20</sup> s 250R(2), (3). The shareholder vote on the remuneration report is advisory only, but the two-strikes rule in Part 2G.2 Div 9, introduced in 2011, gives it a real, not merely an advisory, effect. Under that rule, shareholders have the opportunity to pass a simple majority spill resolution vacating a company's board and requiring the directors to stand for re-election if, at two consecutive AGMs, the remuneration report for the relevant year receives at least 25% 'no' votes.

<sup>21</sup> s 250R(1)(a).

<sup>22</sup> s 250R(1)(b). A person appointed to fill a casual vacancy on the board of a public company can remain as a director only with the approval of shareholders at the company's next AGM: s 201H(3) (a replaceable rule). ASX Listing Rule 14.4 provides that a director appointed to fill a casual vacancy on, or as an addition to, the board of a public listed entity must not hold office, without re-election by shareholders, past the next AGM of the entity.

<sup>23</sup> s 250R(1)(c), (d).

<sup>24</sup> s 136.

<sup>25</sup> Chapter 2J of the Corporations Act.

<sup>26</sup> Shareholders of a public company may at any time, including at the AGM, by ordinary resolution, remove one or more directors: s 203D. A company's constitution may be amended by special resolution of shareholders: s 136(2). The CAMAC report *Diversity on boards of directors* (March 2009) footnote 12 explains other means by which shareholders can pass resolutions at the AGM, or at other general meetings, to influence the future direction of the company.

<sup>27</sup> s 249R.

<sup>28</sup> s 249S.

For most companies, a reasonable opportunity to participate would mean that each member is able to communicate with the chairman and be heard by other members attending the meeting, including those at the other venues.

If a company uses technology to hold its meetings in more than 1 place, it will need to take into account factors such as:

- (a) the ability of the chairman to conduct and control the proceedings
- (b) the number of persons attending the meeting
- (c) the nature of the business of the meeting (for example, it may include a visual presentation)
- (d) the voting processes available (for example, it will be necessary to have procedures in place to count members' votes from all venues)
- (e) whether persons at the meeting can communicate with the chairman and follow the proceedings.<sup>29</sup>

The language of the statutory accommodation for technology is limited. The provision appears to contemplate a meeting taking place at more than one physical venue where shareholders are in attendance, with the use of technology to link those venues. The provision makes no reference to shareholders participating through the Internet, nor would it appear to contemplate an AGM being held only online.

#### *Further analysis and questions*

The procedures for conducting an AGM under its current functions and format are further discussed in Chapter 5. Questions for consideration are set out throughout that chapter.

### **2.4.3 Future functions and format**

#### *Rethinking the AGM*

The AGM, as it currently operates, is part of a range of avenues for shareholder interaction with the company. For instance, institutional shareholders, through briefings or other communications or contacts with the company, may receive more detailed or up-to-date financial or other information than is contained in the annual report, though any additional material information they receive may have to be publicly disclosed under the continuous disclosure obligations.<sup>30</sup>

Likewise, institutional shareholders may prefer to raise matters directly with the company as they arise, rather than wait and exercise their right to question, comment or vote at the AGM. Also, resolutions to be voted on by shareholders at an AGM are often already decided by proxies lodged by institutional investors in advance of the meeting. Institutional shareholders who have exercised other avenues of communication or influence with the company may see little point in also attending the AGM or actively participating in its deliberations.

<sup>29</sup> Explanatory Memorandum to the Company Law Review Bill 1997 at [10.43]-[10.44].

<sup>30</sup> The continuous disclosure requirements are set out in Chapter 6CA of the Corporations Act and ASX Listing Rule 3.1. ASIC Regulatory Guide 62 *Better disclosure for investors* outlines some steps to prevent engagement with particular shareholders undermining the spirit of the continuous disclosure provisions. Also, in regard to the clarity and quality of the communications made by the company, ASIC Regulatory Guide 228 *Prospectuses: Effective Disclosure for Retail Investors* contains a comprehensive discussion of the idea of 'clear, concise and effective' and represents ASIC's current thinking on how to achieve clear written communication with shareholders.

One consequence of these various forms of engagement is that the numbers attending AGMs are often limited, and predominantly consist of retail shareholders. This has led to debate on whether the AGM, in its current or any other form, performs a useful role. Those supporting the retention of the AGM, in its current or some other form, can point to the opportunity it creates for participants, including institutional shareholders if they consider that there is a need, publicly to express their position or concerns on matters of importance to them, and to ask questions directly to directors and others who are under a duty to act in the best interests of the company. Other parties may take the view that the functions of an AGM should be reconsidered in some manner or the obligation to hold an AGM be abolished.

While there is some recognition in the legislation of the use of technology in conducting AGMs, questions arise whether companies should be given greater latitude in this respect, including the use they might make of the Internet to hold the AGM.

### *Further analysis and questions*

Matters concerning the future of the AGM as a corporate governance and accountability mechanism, whether its functions should be changed in some manner, and the possible range of formats that the AGM could take, if retained, are further discussed in Chapter 6. Questions for consideration are set out throughout that chapter.



## 3 Shareholder engagement

*This chapter provides contextual information and analysis for Issue 1 of the paper. It outlines thinking and developments on ongoing engagement between a company and its shareholders, and the consequences for the AGM. It discusses approaches and developments in Australia and elsewhere.*

### 3.1 Approaches in Australia

#### 3.1.1 Overview

Shareholder engagement in Australia takes place within a legal framework that supports periodic, as well as event-driven, communications to shareholders. For instance, companies are required to communicate with shareholders and the market in complying with the continuous disclosure obligations under the legislation and the ASX Listing Rules.<sup>31</sup> Methods of engagement with shareholders need to be sensitive to the requirements of this framework. There may be issues, for instance, in conducting selective shareholder briefings.<sup>32</sup>

#### *Guidance on engagement*

The ways and extent to which companies engage with their shareholders is influenced by the guidance to companies provided by the ASX Corporate Governance Council *Principles and Recommendations*.

Also, standards on engagement practices applicable to various types of institutional investors have been put forward by industry bodies, such as the Financial Services Council, which represents fund managers, and the Australian Council of Superannuation Investors, which represents asset owners.

The AICD paper *Institutional share voting and engagement* (September 2011) also commented on the guidance available in relation to shareholder engagement.

These matters are further discussed in Section 3.1.2.

#### *The engagement process*

The Parliamentary Joint Committee on Corporations and Financial Services (PJC) in its report *Better shareholders – Better company* (June 2008) pointed to various factors that companies and shareholders, in practice, take into account in determining their levels of engagement. Similar observations were made by the Productivity Commission in its Report *Executive Remuneration in Australia* (December 2009).

The September 2011 AICD paper contained a number of findings and observations on the engagement process.

These matters are further discussed in Section 3.1.3.

<sup>31</sup> ss 674, 675, ASX Listing Rule 3.1. See also ASIC Regulatory Guide 198 *Unlisted Disclosing Entities: continuous disclosure obligations*.

<sup>32</sup> See ASX Guidance Note 8, which refers to ASIC Regulatory Guide 62 *Better disclosure for investors*.

### *Corporate briefings*

One means of engagement is through corporate briefings to particular shareholders. The ASX Corporate Governance Council provides guidance to companies in conducting briefings. The PJC report *Better shareholders – Better company* (June 2008) considered this matter. Also, the CAMAC report *Aspects of market integrity* (2009), while recognising the role of briefings in supplementing formal disclosures to the market through annual and other reporting, considered that it was in the interests of a well-run company to place controls on these forms of communication to ensure compliance with legal requirements as well as maintain investor confidence in the integrity of the market in the company's shares.

These matters are further discussed in Section 3.1.4.

### *Proxy advisers*

Information on the role of proxy advisers is provided by CSA. The role of proxy advisers was considered by the Productivity Commission in its report *Executive Remuneration in Australia* (December 2009).

The September 2011 AICD paper outlined independent research on the proxy advisory process. Also, Allens Linklaters has conducted a survey of views by its listed clients on the role and influence of proxy advisers.

These matters are further discussed in Section 3.1.5.

### *Shareholders calling meetings*

Another means by which shareholders may seek to engage with the company is by exercising their rights to call extraordinary general meetings, to consider resolutions on which shareholders lawfully may vote.

These matters are further discussed in Section 3.1.6.

## **3.1.2 Guidance on engagement**

### *ASX Corporate Governance Council*

The ASX Corporate Governance Council *Principles and Recommendations* describe the annual general meeting as 'the central forum by which companies can effectively communicate with shareholders, provide them with access to information about the company and corporate proposals, and enable their participation in decision-making'.<sup>33</sup>

In addition, the *Principles and Recommendations* contain various general statements relevant to the role of companies in promoting ongoing engagement with shareholders. For instance, Principle 6 (respect the rights of shareholders) is that companies should empower their shareholders by:

- communicating effectively with them
- giving them ready access to balanced and understandable information about the company and corporate proposals
- making it easy for them to participate in general meetings.

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<sup>33</sup> Corporate Governance Council *Corporate Governance Principles and Recommendations with 2010 Amendments* (2nd edition) at 32.

In this context, Recommendation 6.1 is that:

Companies should design a communications policy for promoting effective communication with shareholders and encouraging their participation at general meetings and disclose their policy or a summary of that policy.

To assist that process, Box 6.1 sets out suggestions on how companies can use their websites to improve shareholder participation and enhance market awareness.

[The ASX Corporate Governance Council has announced that it has been reviewing its Principles and Recommendations, including Principle 6, with a view to publishing a third edition of the Principles and Recommendations, to capture and reflect developments in Australia and internationally in corporate governance matters. The new edition will include matters concerning corporate engagement with security holders, both generally and at the AGM. The Council anticipates issuing a consultation paper and an exposure draft of the third edition in mid-2013. Consultation is expected to be completed in the third quarter of 2013, with the issue of a third edition of the Principles and Recommendations in the fourth quarter of 2013.](#)<sup>34</sup>

### **Financial Services Council**

#### *General engagement*

The Financial Services Council (FSC) *Blue Book* (2009) contains guidance for fund managers in engaging with companies in which they invest.

For instance, Guideline 2 is that fund managers should establish direct contact with companies in accordance with their corporate governance policy. Engagement with companies should include constructive communication with both senior management and board members about performance, corporate governance and other matters affecting shareholders' interests.

The commentary on that Guideline notes that, in addition to company annual and other general meetings, companies may conduct road shows and provide analyst briefings. However, given the responsibilities of fund managers to their clients, and the significant amount of capital at stake, those managers should establish direct contact with companies about performance and corporate governance issues. Two-way communication between companies and fund managers is an important aspect of corporate governance, enabling each party to assess more fully the concerns and prospects of the company.

The Blue Book also points out that this Guideline should not be taken to advocate any conduct inconsistent with insider trading, continuous disclosure and other corporate laws. If information is in a proper form to disclose to a fund manager as part of the engagement process, the company should consider whether it has a duty to disclose the information to the market under the ASX Listing Rules and continuous disclosure requirements.

#### *Voting policy*

The revised draft FSC Standard No. 13 *Proxy Voting Policy* (issued for consultation in August 2012) would require each FSC member who operates one or more schemes:

- to formulate and maintain a voting policy (including proxy voting), accessible to scheme members, for each scheme that it operates

<sup>34</sup> [ASX Corporate Governance Council Media release 4 December 2012.](#)

- to disclose as part of that voting policy whether it engages the services of voting or proxy advisers in exercising its voting rights
- to vote in respect of all resolutions for its investments in Australian-listed entities unless for good reason it abstains from exercising its voting rights, and
- to maintain and disclose to scheme members in respect of a financial year its voting record (including abstentions) in respect of the relevant scheme investments on a ‘per Scheme, per investment and per resolution’ basis.

### **ACSI**

The Australian Council of Superannuation Investors (ACSI) *A Guide for Superannuation Trustees* (2011) provides guidance concerning engagement and other practices that ACSI believes Australian companies should follow in conducting their business. Part D of the Guide covers various aspects of the company’s relationship with its shareholders, including board accountability to shareholders, such as:

The board should respond, where practicable, to communications from shareholders. In particular, shareholders should have access to non-executive directors.

Any shareholder proposal approved by a majority of votes cast should either be adopted by the board, or the next annual report should contain a detailed explanation of the board’s progress towards the introduction of the proposal.<sup>35</sup>

### **AICD paper**

The AICD paper *Institutional share voting and engagement* (September 2011) (involving independent research conducted by Mercer) found that share voting policies of institutions, proxy advisers and industry groups are important influences on institutional share voting.<sup>36</sup> The paper noted that there are many share voting and governance policies, such as the FSCs ‘Blue Book’ and the ACSI Governance Guidelines. Companies listed on the ASX must report against the ASX Corporate Governance *Principles and Recommendations*. The various policies are very similar, differing only at the margins. Also:

the existence of published share voting policies and guidelines means companies should not be surprised at a high ‘against’ vote on a resolution that contravenes general policy.<sup>37</sup>

The paper also found that institutional shareholders have been increasingly active in voting generally and are increasingly willing to vote against company resolutions if it is in their interests to do so.<sup>38</sup>

### **3.1.3 The engagement process**

#### ***The PJC report***

The PJC report *Better shareholders – Better company* (June 2008) noted that the predominant view of respondents was that the current regulatory framework for corporate governance did not obstruct engagement between shareholders and companies.<sup>39</sup> Rather, the degree to which retail or institutional shareholders seek to engage with their companies,

<sup>35</sup> Section 18(c) and (d).

<sup>36</sup> Finding 5.

<sup>37</sup> at 6.

<sup>38</sup> Finding 3.

<sup>39</sup> para 2.19.

including by questioning, forming opinions and voting at an AGM, remains a matter for each of these investors. While engagement by institutional investors may be increasing overall, particular shareholders will still determine their level of engagement on the basis of relative costs and benefits to them, and, even when engaged, may prefer influencing corporate governance outcomes through discussion with the board rather than, say, casting negative proxy votes at AGMs.<sup>40</sup>

The PJC report noted the preference of respondents to the inquiry for a non-regulatory approach to improving shareholder engagement in Australia.<sup>41</sup> The PJC considered that minimum standards of engagement should not be imposed on companies, though ‘companies that have failed to adequately facilitate shareholder engagement and participation need to be pressed harder to do so’.<sup>42</sup>

The PJC report referred to the potential ‘dampening’ effect of the takeover provisions on institutional shareholders acting collectively.<sup>43</sup> However, ASIC has set out the circumstances where discussions between shareholders may take place without attracting these provisions and when ASIC will provide Class Order relief so that shareholders can enter into agreements about voting at an AGM or other shareholder meeting.<sup>44</sup>

The PJC report noted that the costs to some retail investors of engagement leading up to the AGM or otherwise may outweigh the possible benefits. The report referred to a submission that:

questioned the reasonableness of any expectation for retail shareholders to be engaged with companies, proposing instead that ‘rational apathy ... is often optimal’. When dissatisfied with company performance or direction, retail investors selling their shareholding remains the most effective option.<sup>45</sup>

### *Productivity Commission*

The Productivity Commission Report *Executive Remuneration in Australia* (December 2009) noted that the extent to which shareholders will wish to be involved in corporate governance matters will depend on a number of factors, including the level and purpose of their investment, any statutory responsibilities associated with it, their interest in such matters and other priorities.

Investors will weigh up the costs and benefits associated with monitoring, engaging and voting. For a small retail investor, the benefits associated with voting are likely to be small. Given the size of their investments, institutional investors are more likely to engage with a company ...<sup>46</sup>

### *AICD Paper*

The AICD paper *Institutional share voting and engagement* (September 2011) (involving independent research conducted by Mercer) contained a number of findings and observations concerning the engagement process and its effect on voting at AGMs.

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<sup>40</sup> paras 3.3-3.12.

<sup>41</sup> para 2.1.

<sup>42</sup> para 2.25.

<sup>43</sup> para 3.42, referring to s 606 of the Corporations Act, combined with the broad definitions of ‘relevant interest’ and ‘associate’ in ss 12 and 15.

<sup>44</sup> ASIC Regulatory Guide 128 *Collective action by institutional investors*.

<sup>45</sup> para 3.50.

<sup>46</sup> at 303.

The paper noted that the institutional share voting environment is characterised by high volume decision making in a compressed time prior to the AGMs of public companies. This has an impact on how institutional share owners (both managed funds and superannuation funds) conduct share voting – in particular what functions they do themselves, and what functions they outsource to advisers.<sup>47</sup>

In this context, the paper noted that about 80% of votes cast by institutional investors on listed company resolutions occur in a six- to eight-week period (in October-November) when approximately 80% of listed companies hold their AGMs. The paper observed that pressure generated by this number and concentration of meetings has an effect on how institutional investors organize their share voting activities - there is a strong incentive to outsource parts of the process (including research/proxy advice) to proxy advisers for cost and efficiency reasons.

The paper also observed that institutional share voting, being a high volume, compressed time, process also shapes how the parties communicate with each other:

Access by companies to institutional share owners and proxy advisory firms is limited in the peak proxy season with communication restricted to exceptional matters – institutional share owners are busy with voting lodgment at this point. Company directors, however, wish to have greater access to institutional share owners and proxy advisers during the peak proxy season.<sup>48</sup>

Communication between companies and institutional share owners is likely to be more effective outside of the peak proxy season.<sup>49</sup>

The paper also observed that companies and directors are often not communicating with the real decision makers in institutional investors:<sup>50</sup>

Whereas companies think the decision makers are, or should be, at the peak of the organisation (for example, the chief executive or chief investment officer), the reality is that voting decisions are made lower down the organisational chain, at the portfolio manager, analyst or governance officer level.<sup>51</sup>

### 3.1.4 Corporate briefings

#### *ASX Corporate Governance Council*

In its Commentary on Recommendation 6.1, the Council proposes that:

Where possible, companies should arrange for advance notification of significant group briefings (including, but not limited to, results announcements) and make them widely accessible, including through the use of webcasting or any other mass communication mechanisms as may be practical.<sup>52</sup>

The Commentary also states that listed entities should consider webcasting or teleconferencing such briefings or posting a transcript or summary of the transcript on their websites.<sup>53</sup>

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<sup>47</sup> Finding 1.

<sup>48</sup> Finding 2.

<sup>49</sup> *ibid.*

<sup>50</sup> Finding 8.

<sup>51</sup> *ibid.*

<sup>52</sup> at 31.

<sup>53</sup> Box 6.1.

Commercial organizations may offer shareholders access to corporate briefings and other information provided electronically by companies.

### *PJC*

The PJC report *Better shareholders – Better company* (June 2008), in considering the question of the equitable distribution of company information to different classes of shareholders, raised the practice of companies offering private briefings to institutional shareholders and whether this in some cases could breach the continuous disclosure requirements or otherwise disadvantage retail investors.

The report supported companies holding private briefings with institutional investors provided they are conducted within the continuous disclosure parameters under the Corporations Act and ASX Listing Rule 3.1. The PJC also considered that companies should post the information contained in private briefings on their websites. If possible, this information should be available at the same time as the briefing itself and shareholders should be forewarned of its pending availability to provide the most equitable access.<sup>54</sup>

### *CAMAC*

The CAMAC report *Aspects of market integrity* (2009) included an examination of the role of corporate briefings to analysts and others, such as institutional shareholders.<sup>55</sup> It considered that:

The practice by which listed companies provide briefings from time to time to analysts, institutional investors and others on their business and performance provides a useful and probably necessary supplement to their formal disclosures to the market through their annual and other reporting and in their continuous disclosures.<sup>56</sup>

The CAMAC report noted various legislative prohibitions and obligations relevant to these types of communication, in particular the prohibitions on insider trading and market misconduct, as well as the continuous disclosure requirements. It also referred to the need to keep the market promptly informed of any material price-sensitive information provided at private briefings, while noting the benefits of disseminating information given at open briefings through webcasts or other publicly accessible electronic means.

CAMAC concluded that, while it did not see a need for further legislative intervention:

The Committee sees scope for further promotion of best practice in this area. It is in the interests of a well-run company, as part of an effective communication strategy, to control its communications with analysts and others concerning its business and affairs. An appropriate policy would clarify responsibilities for speaking and presenting information on behalf of the company and aim for consistency and accuracy in communication as well as compliance with legal requirements.<sup>57</sup>

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<sup>54</sup> at 3.102-3.103.

<sup>55</sup> Chapter 5.

<sup>56</sup> Section 5.8.

<sup>57</sup> *ibid.*

The CAMAC report set out a series of suggestions for possible amendments to the ASX Corporate Governance Council *Principles and Recommendations* that would build on existing regulatory and industry guidance concerning these briefings.<sup>58</sup>

### 3.1.5 Proxy advisers

The major proxy advisers in Australia hold an Australian financial services licence, issued by ASIC.<sup>59</sup> All licensees are subject to statutory obligations in carrying out their functions.<sup>60</sup>

#### CSA

The CSA publication *Better Communication between Entities and Proxy Advisory Services* (2008) provides background information on the role of proxy advisory services, including in the lead-up to the AGM. In essence, these services:

evaluate the numerous resolutions proposed by entities and make recommendations to institutional investors on how to vote on these resolutions.<sup>61</sup>

It was pointed out that, given the current legislative requirements for the holding of AGMs, the majority of these meetings are held in the two month period from October to November each year and that this:

introduces constraints into the system, as multiple annual reports and notices of [AGMs] are issued at much the same time, requiring analysis by proxy advisory services within a very tight time frame. This period takes place from mid-September to mid-November. This is referred to as the ‘peak period’ for proxy advisory services.<sup>62</sup>

The publication recommended a number of steps that could be taken to improve communications between companies conducting AGMs and proxy advisory services to institutional shareholders in those companies.<sup>63</sup>

<sup>58</sup> CAMAC suggested, at Section 5.8, that the *Principles and Recommendations* provide guidance for companies conducting briefings to help reduce the possibility of inadvertent selective disclosure of confidential price-sensitive information and maintain investor confidence in the integrity of the market, including that companies:

- have processes to control who is authorised to speak on their behalf
- where possible, particularly in the case of profit announcements, arrange for advance notification of briefings and make them open and accessible, including through use of the Internet
- reinforce the need for briefings or other communications with analysts and other third parties to avoid disclosure of market-sensitive information that is not generally available to the market
- establish processes for checking the information disclosed at briefings and, in the event of inadvertent disclosure of confidential price-sensitive information, make that information generally available to the market
- keep a record of briefings and matters addressed, including those present and the time, place and subject matter of the meeting
- introduce appropriate restraints on the kinds of communications that can occur during periods prior to the release of financial results or at other times of market sensitivity.

<sup>59</sup> Corporations Act Part 7.6. Corp Reg 7.1.30 provides an exemption from the licensing provisions for the provision of certain financial information if the four conditions in the regulation [(a)-(d)] apply. In practice, the major proxy advisory firms are licensed, as their business includes providing advice that relates to a dealing in financial products (for instance, where the advice relates to corporate mergers or reconstructions) and hence fails to satisfy the condition in paragraph (d) of the regulation.

<sup>60</sup> See, for instance, s 912A.

<sup>61</sup> at 3.

<sup>62</sup> at 10.

<sup>63</sup> Chapter 4.

### *Productivity Commission*

The Productivity Commission report *Executive Remuneration in Australia* (December 2009) considered various issues concerning the role of proxy advisers in the voting process at AGMs or other shareholder meetings.

The Commission noted that, prior to exercising their vote, institutional shareholders may seek advice from proxy advisers, who research companies and offer advice to their subscribers on how to direct their proxy vote. The Commission considered that:

This can be an important service for institutional investors who have invested in a large number of companies, as well as for smaller investors who may lack the time or resources to carry out such research themselves.<sup>64</sup>

The Commission also noted concerns about proxy advisers becoming too influential in deciding the outcomes of company resolutions, such as:

- institutional investors simply following the recommendations of proxy advisers without question (for example, because of insufficient resources to analyse the advice)
- proxy advisers lacking the time and resources, particularly during the company reporting season, to engage with companies about areas of concern, and/or adopting inflexible positions on remuneration issues that may not be appropriate for all companies
- the incentive for proxy advisers to find fault with company governance arrangements in order to generate business.<sup>65</sup>

While acknowledging these concerns, the Commission also observed that:

institutional investors have a fiduciary duty requiring them to vote in the best interest of their clients. In addition, while proxy advisers may have incentives to highlight poor corporate governance practice, they will need to be able to back up their recommendations, or risk losing credibility and clients.<sup>66</sup>

The Commission also noted the concern that some proxy advisers may not engage with a company prior to recommending a ‘no’ vote. In the view of the Commission:

While it is unclear how widespread such practices are, *the Commission sees obvious merit in proxy advisers engaging with companies prior to recommending a ‘no’ vote.*<sup>67</sup>

Finally, the Commission considered the proposal that proxy advisers should be prevented from making recommendations on resolutions, given their influence. In rejecting that proposal, the Commission argued that:

since investors are not obliged to follow the guidance of proxy advisers, even if some have that as their default position, such a proposal seems excessive and could perversely result in a reduction in the availability of relevant market information.<sup>68</sup>

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<sup>64</sup> at 313.

<sup>65</sup> at 313-314.

<sup>66</sup> at 314.

<sup>67</sup> *ibid.*

<sup>68</sup> *ibid.*

### *AICD paper*

The AICD paper *Institutional share voting and engagement* (September 2011) (involving independent research conducted by Mercer) stated that its research indicated that proxy advisory firms are an important influence on institutional share voting in Australia.<sup>69</sup>

In this context, the paper noted that:

the high-volume, time-pressured environment means proxy advisers perform a function that most institutional share owners would consider prohibitively costly to do themselves

a theme that emerged from the interviews is the growing acceptance of the role of proxy advisory firms and an evolving relationship between companies and these firms, which is becoming less adversarial and more professional in tone.<sup>70</sup>

The paper also stated that its research had found that a significant minority of company directors think proxy advisers are improperly influential. They believe too much has been outsourced by institutional investors, making proxy advisory firms de facto decision makers.<sup>71</sup> In that context;

A significant number of directors felt very strongly that it was the clear responsibility of institutional investors to actively make voting decisions and to devote sufficient time and resources to think about the issues involved. To do otherwise, they argued, was to abrogate an important responsibility.<sup>72</sup>

### *Allens Linklaters Survey*

A survey in 2012 by Allens Linklaters of its listed clients<sup>73</sup> indicated support from respondents for the proposition that use of proxy advisers in the AGM voting process should be restricted or regulated:

Proxy advisors may be employed by shareholders to consider issues and motions raised at AGMs and to make recommendations to shareholders as to how they should vote. Their increasing role in the corporate governance process has been criticised on the basis of queries as to the adequacy of their resources and expertise to decide issues pivotal to a company's future. These sentiments were reflected in the survey.

and

some respondents also expressed concerns that 'proxy advisory firms are effectively dictating to company boards', indicating an underlying concern as to what degree of independent judgment some shareholders were exercising on key issues.<sup>74</sup>

### *Overseas*

An outline of recent thinking [from various jurisdictions](#) on proxy advisers is set out in Section 3.3.2.

<sup>69</sup> Finding 6.

<sup>70</sup> *ibid.*

<sup>71</sup> Finding 7.

<sup>72</sup> *ibid.*

<sup>73</sup> The respondents comprised board chairs, non-executive directors, chief executive officers/chief financial officers, General and Legal Counsel and Company Secretaries of various large, mid and small cap listed companies.

<sup>74</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 11.

### 3.1.6 Shareholders calling meetings

Australia and other jurisdictions allow a group of shareholders to requisition a general meeting of shareholders, independently of the AGM. The directors must call the meeting within 21 days after a valid request is given to the company, with the meeting to be held no later than two months after the request is given to the company.<sup>75</sup> The shareholders making the request may also request the company to give to all shareholders a statement provided by them about a resolution that is proposed to be moved at the general meeting, or any other matter that may properly be considered at the meeting.<sup>76</sup> The company must distribute to all its members a copy of the statement at the same time, or as soon as practicable afterwards, and in the same way, as it gives notice of the general meeting.<sup>77</sup>

That meeting may consider any resolution on which shareholders lawfully may vote. In addition to resolutions that shareholders may pass at any time, such as the removal of a director,<sup>78</sup> shareholders have some ability to initiate resolutions that otherwise may influence the future direction of a company.<sup>79</sup>

The thresholds at which one or more shareholders can exercise this requisition right are generally based on a percentage of the company's issued share capital. Under the Corporations Act, that threshold is 5% of the shares that may be cast at a general meeting.<sup>80</sup> The same threshold applies in the UK and France.<sup>81</sup>

In Australia alone, there is also a right for 100 shareholders to requisition a meeting regardless of how much share capital they hold collectively.<sup>82</sup> The issue is whether any shareholder numerical test should remain.

The CASAC Report observed that:

The appropriate threshold test for calling a general meeting of a listed public company is a significant matter of corporate governance. The Advisory Committee considers that it is necessary to achieve a balance between legitimate shareholders' rights and the potential abuse of those rights at what could be a substantial cost to the company. Requiring companies to hold extraordinary general meetings at the direction of a small number of shareholders could entail undue costs and distract management from its principal task of conducting the company's affairs, with possible adverse consequences for shareholders generally and customer confidence. Shareholders should therefore have to satisfy a significant threshold test to justify the time and expense of holding an extraordinary general meeting, rather than having matters of concern dealt with at the next annual general meeting. Any threshold test for requisitioning an extraordinary

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<sup>75</sup> s 249D(5).

<sup>76</sup> s 249P(1).

<sup>77</sup> s 249P(6).

<sup>78</sup> s 203D.

<sup>79</sup> Shareholders need to frame their resolutions appropriately, as a general meeting does not have the power to pass binding resolutions that interfere with the exercise of powers vested in the board: *Gramophone & Typewriter Ltd v Stanley* [1908] 2 KB 89 at 105; *Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113 at 134; *Scott v Scott* [1943] 1 All ER 528; *NRMA v Parker* (1986) 4 ACLC 609. For instance, a proposed resolution by shareholders that, say, the company adopt a charter with particular environmental or social policies or goals could be framed in terms of a proposed amendment to the company's constitution: s 136(2) (which requires a special resolution). A charter of this nature could be seen as reducing board decision-making autonomy. However, in *Whitehouse v Carlton Hotel Pty Ltd* (1987) 162 CLR 285 at 291, the High Court stated that:

the articles of a company may be so framed that they expressly or impliedly authorise the exercise of [a] power ... for what would otherwise be a vitiating purpose.

<sup>80</sup> s 249D(1)(a).

<sup>81</sup> *Companies Act 2006* (UK) s 303, Article R225-71 of the French Commercial Code.

<sup>82</sup> s 249D(1)(b). For instance, in *Woolworths Limited v GetUp Limited* [2012] FCA 726, the company received a letter enclosing notices signed by 210 current members containing a request to the directors to call a general meeting and to circulate to all shareholders a statement signed by those members.

general meeting should be substantial and apply uniformly to all listed public companies.<sup>83</sup>

The Report recommended that the shareholder numerical test be repealed and that only shareholders who, collectively, hold at least 5% of the votes that may be cast at a general meeting should have the power to requisition a general meeting of a listed public company.<sup>84</sup> Holding a general meeting can be a costly and time-consuming exercise.<sup>85</sup>

## 3.2 Approaches in the United Kingdom

### 3.2.1 Overview

The process of ongoing shareholder engagement with companies is influenced by two regulatory approaches:

- the UK Corporate Governance Code (the Corporate Governance Code), which deals with the role of the board. The Corporate Governance Code can be compared with the ASX Corporate Governance Council *Principles and Recommendations*
- the UK Stewardship Code (the Stewardship Code), which deals with the role of various institutional shareholders in actively engaging with the companies in which they invest. There is no direct equivalent in Australia of the Stewardship Code, though there are somewhat comparable industry-based initiatives.<sup>86</sup>

Both UK Codes are voluntary in that they operate on a ‘comply or explain’ basis, with listed companies or relevant institutional shareholders to state that they comply with the Code, and if so provide a statement on how they have applied its principles, or explain why they have not complied.<sup>87</sup>

The emphasis in both UK Codes is ongoing engagement between the board and shareholders, not just at the AGM, in response to:

what is called in the US the ‘pig in the python’ problem – the fact that so much of engagement activity is concentrated into the few months between companies’ annual reports and annual general meetings, most of which take place at the same time of year.<sup>88</sup>

Both Codes are the responsibility of the UK Financial Reporting Council (FRC).

The Corporate Governance Code is further discussed in Section 3.2.2.

<sup>83</sup> para 2.19.

<sup>84</sup> rec 2.

<sup>85</sup> See further S Bottomley, *The Role of Shareholders’ Meetings in Proving Corporate Governance*, ANU Research Report 2003 regarding the cost of calling a meeting, and Treasury Research Note 18, Mark Tapley, *How Many Shareholders Should it Take to Call a Meeting?* February 2002.

<sup>86</sup> See the revised draft FSC Standard No. 13 *Proxy Voting Policy* (August 2012), discussed under **Financial Services Council** in Section 3.1.2.

<sup>87</sup> The ‘comply or explain’ approach is a recognition of the benefits of a more flexible corporate governance framework, enabling issuers or relevant institutional shareholders to apply corporate governance standards in a way that is effective and reflects the nature of their business, while enabling investors to scrutinise the way those standards have been applied where necessary. See further, UK Financial Reporting Council (FRC) *What constitutes an explanation under comply-or-explain? Report on discussions between companies and investors* (February 2012), [FRC Comply or Explain: 20<sup>th</sup> Anniversary of the UK Corporate Governance Code \(2012\)](#).

<sup>88</sup> FRC, *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) at 2.

The Stewardship Code is further discussed in Section 3.2.3.

[Private sector guidance on engagement between companies and investors is discussed in Section 3.2.4.](#)

### 3.2.2 Role of the board

The Corporate Governance Code covers a number of matters concerning the board, including, in Section E, its responsibility for ensuring that a satisfactory ongoing dialogue with shareholders takes place to understand their issues, opinions and concerns. For this purpose:

The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders. The senior independent director should attend sufficient meetings with a range of major shareholders to listen to their views in order to help develop a balanced understanding of the issues and concerns of major shareholders.<sup>89</sup>

The board should state in the annual report the steps they have taken to ensure that the members of the board, and, in particular the non-executive directors, develop an understanding of the views of major shareholders about the company, for example, through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.<sup>90</sup>

[The most recent edition of the Corporate Governance Code commenced in October 2012.<sup>91</sup> This edition does not make any amendment to Section E, as it applied prior to that date.](#)

### 3.2.3 Role of institutional shareholders

#### [Overview of the Stewardship Code](#)

The Stewardship Code, which commenced in July 2010, seeks to assist companies to understand the approach and expectations of their major shareholders.<sup>92</sup> The Code is directed in the first instance to institutional investors, [being asset owners and asset managers with equity holdings in UK listed companies](#). The Code also applies to service providers, such as proxy advisers and investment consultants.

From December 2010, the UK Financial Services Authority (FSA) has required all firms authorised to manage funds on behalf of others to disclose 'the nature of its commitment' to the Code or 'where it does not commit to the Code, its alternative investment strategy'.<sup>93</sup>

<sup>89</sup> Section E.1.1.

<sup>90</sup> Section E.1.2. See also FRC *Guidance on board effectiveness* (March 2011), paras 7.1-7.3.

<sup>91</sup> [For a summary of the background to the changes to the Corporate Governance Code, see the FRC Feedback Statement: Revisions to the UK Corporate Governance Code and Guidance on Audit Committees \(September 2012\).](#)

<sup>92</sup> The Stewardship Code traces its origins to the 'The Responsibilities of Institutional Shareholders and Agents: Statement of Principles' which was first published in 2002 by the Institutional Shareholders Committee (ISC), and which the ISC converted to a code in 2009. Following the 2009 Walker Review of the corporate governance of UK banks and other financial institutions, the FRC was invited to take responsibility for the Code. In July 2010, the FRC published the first edition of the Stewardship Code, which closely mirrored the ISC Code. [The second edition of the Code, which does not change the spirit of the first edition, came into force in October 2012.](#)

<sup>93</sup> FSA Conduct of Business Rule 2.2.3.

The opening [commentary to the Code points out that:](#)

[For investors, stewardship is more than just voting. Activities may include monitoring and engaging with companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. Engagement is purposeful dialogue with companies on these matters as well as on issues that are the immediate subject of votes at general meetings.](#)<sup>94</sup>

[However:](#)

[Compliance with the Code does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding, where this is considered in the best interest of clients or beneficiaries.](#)<sup>95</sup>

The Stewardship Code operates on a ‘comply or explain’ basis for institutional investors.<sup>96</sup> [For this purpose, the FRC expects signatories to the Code to publish on their website, or if they do not have a website in another accessible form, a statement that:](#)

- [describes how the signatory has applied each of the seven principles of the Code and discloses the specific information requested in the guidance to the principles; or](#)
- [if one or more of the principles have not been applied or the specific information requested in the guidance has not been disclosed, explains why the signatory has not complied with those elements of the Code.](#)<sup>97</sup>

The FRC also recognises that not all parts of the Code are relevant to all institutional investors:

For example, smaller institutions may judge that some of its principles and guidance are disproportionate in their case. In these circumstances, they should take advantage of the “comply or explain” approach and set out why this is the case.<sup>98</sup>

The Stewardship Code is under consideration in other European jurisdictions.<sup>99</sup>

[The first version of the Stewardship Code operated from July 2010 until September 2012 \(the 2010 Edition of the Stewardship Code\). A revised version of the Stewardship Code commenced in October 2012 \(the 2012 Edition of the Stewardship Code\).](#)

### [The 2010 Edition of the Stewardship Code](#)

The [2010 Edition of the](#) Stewardship Code had seven principles:

Institutional investors should:

- publicly disclose their policy on how they will discharge their stewardship responsibilities (Principle 1)

<sup>94</sup> [at 1.](#)

<sup>95</sup> [at 1.](#)

<sup>96</sup> [at 4.](#)

<sup>97</sup> [at 2.](#)

<sup>98</sup> [at 4.](#)

<sup>99</sup> For instance, the Autorité des marchés financiers (AMF), *Report of the Working Group on General Meetings of Shareholders of Listed Companies* (February 2012) at 12 referred to a possible review to consider establishing in France a code for institutional investors along the same lines as the UK Stewardship Code.

- have a robust policy on managing conflicts of interest in relation to stewardship and this policy should be publicly disclosed (Principle 2)
- monitor their investee companies (Principle 3)
- establish clear guidelines on when and how they will escalate their activities as a method of protecting and enhancing shareholder value (Principle 4)
- be willing to act collectively with other investors where appropriate (Principle 5)
- have a clear policy on voting and disclosure of voting activity (Principle 6)
- report periodically on their stewardship and voting activities (Principle 7).

The FRC provided Guidance on each of these Principles.

### *Experience with the [2010 Edition of the Stewardship Code](#)*

In December 2011, the FRC published its review of the first 18 months of the operation of the Stewardship Code (the review),<sup>100</sup> providing an indication of its take-up<sup>101</sup> and impact, as well as matters requiring further consideration.

### *Incentive to apply the Code*

The review noted that the quality of the statement of investment managers on the extent to which they apply the Stewardship Code can have significant repercussions for their business:

the statement is a primary source of information for those who the Code is ultimately intended to benefit, the asset owners who award investment mandates and, behind them, their beneficiaries. There are signs that the market is beginning to scrutinise statements with the aim of differentiating the level of stewardship on offer. This is encouraging, especially if differentiation becomes a widespread practice among a range of participants, because it should ultimately mean that stewardship becomes a factor in choosing investment managers. Those that choose not to comply with a specific principle will need to deliver an increasingly meaningful explanation in order to generate and retain business.<sup>102</sup>

### *Reporting on stewardship*

The review noted that the better statements by major shareholders cover each of the Code's seven principles in sufficient detail to convey a real sense of how the signatory approaches its responsibilities. However, the review also identified a number of areas where the FRC considered that disclosures under the Stewardship Code could be enhanced. The FRC commented in the review that:

- reporting of how conflicts of interest are managed is frequently weak. Relatively few signatories state categorically that they always seek to place the interest of their clients first. This could be because they feel under legal constraint or because the interest of the client itself may not be clear
- many statements around the principle on collective engagement focus on membership of collective bodies. While this is welcome, it skirts round the main reason for this

<sup>100</sup> FRC, *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) at 20-29.

<sup>101</sup> As of December 2011 the Stewardship Code has attracted 234 signatories, including 175 investment managers, 48 asset owners and 12 service providers: at 20.

<sup>102</sup> at 21.

principle, which is the need for investors to be able to join forces at critical moments to ensure that boards acknowledge and respond to their concerns

- few statements provide much detail about how the signatory uses proxy voting agencies. This is being actively debated in the EU, with several Member States pressing the European Commission for regulation. Critical to the debate on this will be the way in which investors use the recommendations provided by proxy advisers. A clear sense that they are being used responsibly will help alleviate pressure for excessively prescriptive regulation of these agencies.<sup>103</sup>

The FRC indicated that it would consider strengthening the language in the Stewardship Code in each of these areas.<sup>104</sup>

The review also identified an issue around accessibility. It was noted that the FRC website provides a link to all signatory statements, but these statements are not necessarily easily accessible via another route:

It would help if statements were easy to find and also if each statement explained how the signatory could be contacted, preferably by identifying the contact details of an individual who can handle queries from those wishing to discuss stewardship issues, including possible collective engagement.<sup>105</sup>

#### *Engagement: the company perspective*

*General comments.* The review commented that companies perceive that there is still a long way to go before the investment and corporate governance functions within institutional shareholders become properly integrated. Some larger companies have experienced a growing interest on the part of some institutional investors to discuss a wider range of strategic and governance issues, and some additional interest from these investors to meet with chairmen for strategic discussion, although usually it falls to the company to initiate those discussions. However, the majority of companies, in particular smaller companies, have noted relatively little change in approach to engagement by shareholders or in the identity of those investors who are normally involved.<sup>106</sup>

*Proxy advisers.* The FRC noted in the review a concern on the part of companies that some investors are uncritical in following the recommendations of proxy voting agencies, even when this conflicts with the result of their own engagement. Overseas clients in particular are seen as more inclined to rely on proxy advisers.<sup>107</sup>

In a subsequent document, the FRC noted that the issue of proxy advisers is being actively debated in the European Union, with several EU Member States pressing the European Commission for regulation:

Critical to the outcome will be the way in which investors use the recommendations provided by proxy advisers. A clear sense that they are being used to inform, rather than substitute for, investors' stewardship activities could help alleviate pressure for prescriptive regulation.<sup>108</sup>

<sup>103</sup> at 21–22.

<sup>104</sup> at 29.

<sup>105</sup> at 22.

<sup>106</sup> at 23.

<sup>107</sup> *ibid.*

<sup>108</sup> FRC *Revisions to the UK Stewardship Code Consultation Document* (April 2012) at 7.

The FRC proposed revisions to the Stewardship Code concerning use of proxy advisers (see [2012 edition of the Stewardship Code](#), post).

*Engagement: the shareholder perspective*

The review noted that shareholder views on the attitude of companies are similarly mixed:

There is anecdotal evidence that some companies are making a greater effort to engage, with more chairmen taking the initiative of contacting key shareholders. Yet there is also criticism that some companies are becoming less responsive to shareholder votes and more inclined to ignore a significant ‘oppose’ vote as long as they win majority support.<sup>109</sup>

The FRC commented on this outcome that:

Insofar as the Stewardship Code aims to promote better relations between companies and their shareholders, this reaction is counterproductive and ultimately risks undermining the concept of ‘comply or explain’.<sup>110</sup>

The review also noted that:

Comments from larger companies suggested that they felt able to have meaningful discussions with the majority of their main shareholders, although some questioned whether investors had enough people with the right skills to cope with the quantity of engagement that was being sought.<sup>111</sup>

*AGMs and voting*

The FRC pointed out in the review that, while a conscientious approach by institutional shareholders to voting at an AGM, and other shareholder meetings, is an important ingredient of their role, the success of the Stewardship Code should not be measured by the volume of ‘oppose’ votes at such meetings:

The Code makes it plain that shareholders should be prepared to vote against management where they have serious concerns that are not being addressed, but reaching this point can indicate a failure in the relations between companies and their shareholders. What matters is considered voting, and sometimes a demonstration of shareholder support for a company may be as important as a vote against.<sup>112</sup>

*Barriers to stewardship*

The review identified the most significant barriers to stewardship from the shareholder perspective were (in descending order):

- lack of shareholder resources
- limited shareholder influence as a result of the size of the shareholding
- concerns over shareholders acting in concert.

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<sup>109</sup> at 24.

<sup>110</sup> *ibid.*

<sup>111</sup> *ibid.*

<sup>112</sup> at 25.

In response, the FRC commented in the review that:

Inssofar as institutional investors do feel their individual influence is waning, this highlights the importance of collective engagement. Institutions therefore need to find a way of working together more strategically and proactively ...

It would [also] help if ways could be found to allay lingering concerns about acting in concert. While both the Takeover Panel and the Financial Services Authority have offered comfort statements to institutions on this point, more could arguably be done.<sup>113</sup>

The review commented that another barrier to effective engagement is the concentration of AGMs over a short period of time:

This makes it very difficult for investors with large portfolios to scrutinise properly the resolutions being put forward.<sup>114</sup>

### [The 2012 Edition of the Stewardship Code](#)

Following on from the December 2011 review of the Stewardship Code, the FRC published in April 2012 draft revised Stewardship Code Principles and Guidance, with a view to issuing an amended Stewardship Code by October 2012.<sup>115</sup> [The 2012 Edition of the Stewardship Code came into operation in October 2012.](#)<sup>116</sup>

[The 2012 Edition maintained, but in part reworded,](#) the 7 Principles, as follows:

[So as to protect and enhance the value to the ultimate beneficiary, institutional investors should:](#)

- [publicly disclose their policy on how they will discharge their stewardship responsibilities \(Principle 1\)](#)
- [have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed \(Principle 2\)](#)
- [monitor their investee companies \(Principle 3\).](#)
- [establish clear guidelines on when and how they will escalate their stewardship activities \(Principle 4\)](#)
- [be willing to act collectively with other investors where appropriate \(Principle 5\)](#)
- [have a clear policy on voting and disclosure of voting activity \(Principle 6\)](#)
- [report periodically on their stewardship and voting activities \(Principle 7\).](#)<sup>117</sup>

[Guidance is provided on each of these Principles. For instance, in regard to Principle 3:](#)

<sup>113</sup> at 27.

<sup>114</sup> at 28.

<sup>115</sup> FRC, *Revisions to the UK Stewardship Code Consultation Document* (April 2012) and *Appendix to Consultation Document: Draft Revised UK Stewardship Code* (April 2012).

<sup>116</sup> [See also the FRC Feedback Statement: Revisions to the UK Stewardship Code \(September 2012\), which summarises the main points from the responses to the April 2012 FRC draft revised Stewardship Code Principles and Guidance, as well as the decisions taken by the FRC concerning amendments to the Stewardship Code in light of that consultation and the rationale for those decisions.](#)

<sup>117</sup> at 5.

When monitoring companies, institutional investors should seek to:

- keep abreast of the company’s performance;
- keep abreast of developments, both internal and external to the company, that drive the company’s value and risks;
- satisfy themselves that the company’s leadership is effective;
- satisfy themselves that the company’s board and committees adhere to the spirit of the UK Corporate Governance Code, including through meetings with the chairman and other board members;
- consider the quality of the company’s reporting; and
- attend the General Meetings of companies in which they have a major holding, where appropriate and practicable.<sup>118</sup>

In regard to Principle 4:

Institutional investors should set out the circumstances in which they will actively intervene and regularly assess the outcomes of doing so. Intervention should be considered regardless of whether an active or passive investment policy is followed. In addition, being underweight is not, of itself, a reason for not intervening. Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company’s strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters.

Initial discussions should take place on a confidential basis. However, if companies do not respond constructively when institutional investors intervene, then institutional investors should consider whether to escalate their action, for example, by:

- holding additional meetings with management specifically to discuss concerns;
- expressing concerns through the company’s advisers;
- meeting with the chairman or other board members;
- intervening jointly with other institutions on particular issues;
- making a public statement in advance of General Meetings;
- submitting resolutions and speaking at General Meetings; and
- requisitioning a General Meeting, in some cases proposing to change board membership.<sup>119</sup>

In regard to Principle 6:

Institutional investors should seek to vote all shares held. They should not automatically support the board.

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<sup>118</sup> at 7.

<sup>119</sup> at 8.

If they have been unable to reach a satisfactory outcome through active dialogue then they should register an abstention or vote against the resolution. In both instances, it is good practice to inform the company in advance of their intention and the reasons why.

Institutional investors should disclose publicly voting records.

Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.

Institutional investors should disclose their approach to stock lending and recalling lent stock.<sup>120</sup>

### Summary of changes introduced in the 2012 Edition of the Stewardship Code

A speech given in November 2012 by the Chairman of the FRC summarises the principal initiatives in the 2012 Edition of the Stewardship Code:

Many of the changes to the latest Codes for which we have responsibility – for Stewardship and Corporate Governance – have also been made with the intention of improving communication and engagement between companies and investors.

When the FRC took responsibility for the Stewardship Code in 2010, we took the view that the Statement of Principles by the Institutional Shareholders' Committee ..... should be adopted almost unchanged. In the 2012 edition we have resisted the temptation to add new principles, and have instead sought to clarify and sharpen up what was already there.

So, first: we have toughened the language on conflicts of interest. It is not always clear from the statements made by asset managers how such conflicts are managed, for example, in situations where the interests of different clients converge.

Second: we have asked asset managers to give a clearer picture of how they use proxy voting agencies. Outsourcing activities to third parties does not absolve managers of their responsibilities for stewardship. Proxy agencies must not be seen to stand between you and the companies in which you invest. And there is much unease in boardrooms, at present, about the extent to which they do.

Third: we have asked signatories to explain their policy on stock lending, and in particular whether they recall lent stock for voting purposes. We have not however addressed the issue of voting in pooled funds. This was raised by some of your members, but it is one where we felt there was as yet insufficient consensus to write provisions into the Code. We will be hosting discussions on this in the New Year and hope we can identify a way to take it forward to everybody's satisfaction.

Fourth: we have strengthened the principle of the Code dealing with assurance. There is now a presumption that asset managers should obtain independent assurance that their reports on stewardship accurately reflect what they do - although they can of course choose to explain rather than comply with this. The Code also states that the assurance reports should be made available to clients on request. This provides another mechanism by which owners can hold managers to account, and assess how well their interests are being looked after.

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<sup>120</sup> at 9.

Fifth – and perhaps most importantly – the new version of the Code distinguishes much more clearly the roles of asset owners and asset managers. While individual asset owners ..... have committed to the Code, the way it was first written perhaps made it too easy for others to argue that it was nothing to do with them.

We have never believed that to be the case - quite the opposite, in fact. But we needed to recognise that while some asset owners are in a position to engage directly with companies, the majority will do so indirectly through the mandates given to asset managers. So the Code now states that they should clearly communicate their policies on stewardship to their managers, and seek to hold their managers to account.<sup>121</sup>

### 3.2.4 Guidance on engagement

In the context of the Stewardship Code, and related UK guidance developments,<sup>122</sup> the UK Institute of Chartered Secretaries and Administrators (ICSA) paper *Improving engagement practices between companies and institutional investors* (October 2012) has initiated a consultation process for developing industry guidance concerning the quality of meetings between companies and their institutional investors, throughout the year as well as prior to AGMs.

For instance, the paper observed that the starting point for more productive meetings is clarity in the minds of all participants concerning:

- the purpose of the meeting or meetings
- with whom the communication is to take place
- what is on the agenda
- what preparation is needed
- how long and how frequent the meetings should be.<sup>123</sup>

The paper also set out a proposed mechanism to coordinate company feedback on meetings with investors.<sup>124</sup>

The ICSA steering group intends to issue guidance in March 2013.

## 3.3 Other international initiatives

Attention has been given by various other industry and regulatory bodies to matters concerning:

- the role of institutional shareholders in the engagement process (discussed in Section 3.3.1)
- the role of proxy advisers to shareholders (discussed in Section 3.3.2)

<sup>121</sup> FRC, *Speech by Baroness Hogg, Chairman of the FRC Board*, NAPF Conference, 22 November 2012.

<sup>122</sup> See Investor Stewardship Working Paper 2020 *Stewardship - improving the quality of investor stewardship* (March 2012), the *Kay Review of UK Equity Markets and Long-Term Decision Making* (July 2012). The Kay Review included good practice statements related to asset holders, asset managers and company directors.

<sup>123</sup> Further details are set out in Appendix E of the paper

<sup>124</sup> Further details are set out in Appendix F of the paper.

- [the use of technology by companies to assist shareholder engagement \(discussed in Section 3.3.3\).](#)

[Within that context, in December 2012, the European Commission \(EC\), as part of its ‘Europe 2020’ Strategy, and as a follow-up to its Green Paper \*The EU corporate governance framework\* \(April 2011\), has adopted an \*Action Plan\* outlining future initiatives in European company law and corporate governance.<sup>125</sup>](#)

[The Action Plan includes:](#)

- [future initiatives to increase the level of transparency between companies and their shareholders in order to improve corporate governance, such as:](#)
  - [1. increasing companies’ transparency concerning their board diversity and risk management policies](#)
  - [2. improving corporate governance reporting](#)
  - [3. improving the identification of shareholders by issuers](#)
  - [4. strengthening transparency rules for institutional investors on their voting and engagement policies.](#)
- [future initiatives to encourage and facilitate long-term shareholder engagement, such as:](#)
  - [1. greater transparency on remuneration policies and individual remuneration of directors, as well as a shareholders’ right to vote on remuneration policy and the remuneration report](#)
  - [2. better shareholders’ oversight on related party transactions, i.e. dealings between the company and its directors or controlling shareholders](#)
  - [3. creating appropriate operational rules for proxy advisers \(i.e. firms providing services to shareholders, notably voting advice\), especially in relation to transparency and conflicts of interests.](#)

[In regard to the importance of shareholder engagement, and why it should be encouraged, the EC stated:](#)

[Shareholder engagement is a purposeful dialogue with companies on matters such as strategy, performance, risk, capital structure, corporate governance, including remuneration, etc. It is therefore more than just voting at the general meeting. Shareholder engagement \(or ‘stewardship’\) aims to promote long term success of companies. Effective engagement benefits companies, shareholders and the economy as a whole.](#)

[The two \[EC\] Green Papers on corporate governance in listed companies and banks have found that many shareholders are ‘absent’ from companies. On the other hand, many shareholders have pushed banks to take excessive risks, rather than to promote the long-term success of the company. It is shareholders with long-term liabilities such as pension funds or life-insurers that are most likely to engage. However, evidence shows that many of these also have a rather short-](#)

<sup>125</sup> [European Commission Media release Reference IP/12/1340, Event Date 12/12/2012. \*Commission plans to modernise European company law and corporate governance.\* According to the EC, some of the actions in the \*Action Plan\* will be proposals for new legislation; others could require soft law \(recommendations and corporate governance codes\) or an information campaign, but all are priority actions.](#)

term investment strategy once their funds are being managed by asset managers. Short-term investment strategies focus on turning over the portfolio rather than investing for a long time and engaging on corporate governance matters with investee companies.

This mismatch of interests between asset owners and asset managers has substantially weakened shareholder engagement.<sup>126</sup>

In relation to why institutional investors should be obliged to provide information about their voting and engagement policies, the EC commented that:

The objective is to promote shareholder engagement and ensure that institutional investors (pension funds, insurers, etc.) and their asset managers act in the best long-term interest of their beneficiaries and clients respectively. Transparency about voting and engagement policies would raise awareness on the importance of engagement, it would shed light on whether institutional investors and their asset managers take engagement seriously and how they fulfil their duties to act in the best long-term interest of their beneficiaries, including what the results of their engagement activities are.

This transparency would benefit all investors who would be able to invest on the basis of information on the voting and engagement policies of asset managers and institutional investors.<sup>127</sup>

### 3.3.1 Role of institutional shareholders

#### *International Corporate Governance Network*

The International Corporate Governance Network (ICGN)<sup>128</sup> has set out its views on shareholder engagement in its *Statement of Principles on Institutional Shareholder Responsibilities* (2007). These principles stress the importance of institutional shareholders responsibly undertaking their role and exercising their rights, including putting proper resources into corporate governance, communicating with their companies throughout the year, not just prior to or at the AGM, and recognising their own accountability on these matters to their end-beneficiaries. For instance:

A relationship of trust [between all relevant parties] is more likely to be achieved when institutional shareholders and their agents can demonstrate that they are exercising the rights of ownership responsibly. These include:

#### *Application of consistent policies*

Just as it is important for beneficiaries to be informed of the governance policies adopted by those that act for them, so it is important for companies to be aware of the policies that shareholders are likely to adopt. In most markets this has been made easier by the development of corporate governance codes, which set standards for both sides to understand and apply.

Shareholders should be clear what standards they are applying, and how they monitor investee companies. Where this could lead to a negative vote or an abstention at a general meeting, the company's board should be informed of this, ideally in writing, and of the reasons for the decision, at least in respect of significant holdings.

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<sup>126</sup> [EC Memo 12/972](#)

<sup>127</sup> [ibid.](#)

<sup>128</sup> The ICGN describes itself as a not-for-profit body, founded in 1995, with a global membership of over 500 leaders in corporate governance from 50 countries and with a mission to raise standards of corporate governance worldwide. ICGN members are largely institutional investors who collectively represent funds under management of around US\$18 trillion.

Institutional shareholders should periodically measure and review the effectiveness of their monitoring and ownership activities and communicate the results to their beneficiaries, in such a way as to enhance their understanding without compromising specific engagement efforts.

#### *Engagement with companies*

Responsible owners should make use of their voting rights. A high voting turnout at general meetings will help ensure that decisions are sound and representative. Successful engagement, however, requires more than considered voting. It should also include: maintaining dialogue with the board on governance policies in order to address concerns before they become critical; supporting the company in respect of good governance; and consulting other investors and local investment associations where appropriate ...

They should consider working jointly with other shareholders on particular issues. In working with other investors, they should also respect rules with regard to concert parties ...

Investors should have a clear approach for dealing with situations where dialogue is failing. This should be communicated to companies as part of their corporate governance policy. Steps that may be taken under such an approach include: expressing concern to the board, either directly or in a shareholders' meeting; making a public statement; submitting resolutions to a shareholders' meeting; submitting one or more nominations for election to the board as appropriate; convening a shareholders' meeting; arbitration; and, as a last resort, taking legal actions, such as legal investigations and class actions.

#### *Voting*

... Voting is not an end in itself but an essential means of ensuring that boards are accountable and fulfilling the stewardship obligation of institutions to promote the creation of value. Institutional shareholders should therefore seek to vote their shares in a considered way and in line with this objective. They should develop and publish a voting policy so that beneficiaries and investee companies can understand what criteria are used to reach decisions. Voting decisions should reflect the specific circumstances of the case. Where this involves a deviation from the normal policy institutions should be prepared to explain the reasons to their beneficiaries and to the companies concerned.

Asset managers should have appropriate arrangements for reporting to beneficiaries on the way in which voting policy has been implemented and on any relevant engagement with companies concerned. As a matter of best practice they should disclose an annual summary of their voting records together with their full voting records in important cases. Voting records should include an indication of whether the votes were cast for or against the recommendations of the company management.<sup>129</sup>

In regard to the use by institutional shareholders of governance or proxy advisers:

Where [shareholder] ownership responsibilities are outsourced, institutions should disclose the names of agents to whom they have outsourced together with a description of the nature and extent of this outsourcing and how it is regularly monitored. Where they feel it is not appropriate to name the agents they have employed, they should explain their reasons.<sup>130</sup>

The ICGN is currently undertaking a project to update these principles.

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<sup>129</sup> Extracts from Section 4.1 to Section 4.4.

<sup>130</sup> Extract from Section 4.4.

### **EFAMA**

The European Fund and Management Association (EFAMA),<sup>131</sup> in its *Code for External Governance* (April 2011), sets out a series of high-level best practice principles for the exercise of shareholder rights by investment management companies (IMCs):

The code is ‘principles’ based in that it relies upon good judgement rather than prescription. As such, the recommendations recognise that the ‘best’ approach for many issues depends on the circumstances.<sup>132</sup>

The principles (each with an accompanying best practice recommendation) are that IMCs should:

- have a documented policy available to the public on whether they exercise their ownership responsibilities, and if so how
- monitor their investee companies
- establish clear guidelines on when and how they will intervene with investee companies to protect and enhance value
- consider cooperating with other investors, where appropriate, having due regard to applicable rules on acting in concert
- exercise their voting rights in a considered way
- report on their exercise of ownership rights and voting activities and have a policy on external governance disclosure.

### **Eumedion**

Eumedion, a Dutch corporate governance forum,<sup>133</sup> has set out a series of best practice principles for its members in its *Best practices for engaged share-ownership* (June 2011). These principles, applicable to institutional investors in Dutch companies, seek to be in line to the greatest extent with other guidelines on the behaviour expected of institutional investors, including the UK *Stewardship Code* and the EFAMA *Code for External Governance*.

The best practice principles (with accompanying guidance) include that Eumedion participants:

- monitor their Dutch investee companies
- have clear policies with regard to the exercise of their shareholders’ rights, which may include entering into dialogue with Dutch investee companies and other engagement activities. They are to report at least once per year on the implementation of their policies

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<sup>131</sup> EFAMA describes itself as the representative association for the European investment management industry, representing through its 27 member associations and 51 corporate members about EUR 13.5 trillion in assets under management, of which EUR 8 trillion is managed by 53,000 investment funds at the end of 2010.

<sup>132</sup> EFAMA Code at page 2.

<sup>133</sup> Eumedion (meaning ‘good guardian’ in Greek) describes itself as is an independent foundation, managed by representatives of participants. Its objective is to maintain and further develop good corporate governance in the area of the responsibility of asset owners and asset managers established in The Netherlands. About 70 institutional investors currently participate. Together, they represent and manage more than a thousand billion Euro in assets.

- have clear policies for dealing with situations in which it does not prove possible to convince the board of the Dutch investee company to accept their stances and differences of opinion between the board of the investee company in question and the shareholders remain unresolved
- be willing to deal collectively with other Eumedion participants and other investors where appropriate
- take steps to mitigate any conflicts of interest that arise where institutional investors have other business relations with Dutch investee companies apart from the shareholder relationship alone. Eumedion participants are to have clear and robust procedures for the action to be taken in the event that divergent or conflicting interests arise. The procedures are to be publicly disclosed. Material conflicts of interest are to be disclosed to the institutional clients affected
- have a clear policy on voting, publicly disclose this policy and report at least once per year on the implementation of the policy
- cast informed votes on all the shares they hold in Dutch companies at the general meeting of these investee companies. In the event that a Eumedion participant casts a ‘withhold’ or ‘against’ vote on a management proposal, the Eumedion participant is to explain the reasons for this voting behaviour to the company management, either voluntarily or on the request of the company in question
- publicly disclose at least once in a quarter how they voted the shares in Dutch investee companies.

### **CRISA**

The *Code for responsible investing in South Africa* (July 2011) (CRISA) seeks to provide guidance on how institutional investors should execute investment analysis and investment activities and exercise rights so as to promote sound governance. The Code applies to institutional investors as asset owners (for example, pension funds and insurance companies) as well as service providers of institutional investors (for example, asset and fund managers and consultants). These investors and service providers are required to adopt the principles and practice recommendations in CRISA on an ‘apply or explain’ basis.

The principles (with practice recommendations) include that:

- an institutional investor should demonstrate its acceptance of ownership responsibilities in its investment arrangements and investment activities
- where appropriate, institutional investors should consider a collaborative approach to promote acceptance and implementation of the principles of CRISA and other codes and standards applicable to institutional investors
- an institutional investor should recognise the circumstances and relationships that hold a potential for conflicts of interest and should proactively manage these when they occur
- institutional investors should be transparent about the content of their policies, how the policies are implemented and how CRISA is applied to enable stakeholders to make informed assessments.

### 3.3.2 Role of proxy advisers

[The role of proxy advisers in the engagement process, and their possible level of influence, has received increasing attention in a number of jurisdictions in recent times.](#)

#### *United States*

Under US law, the furnishing of proxy voting advice constitutes a form of ‘solicitation’ which is subject to information and filing requirements in the proxy rules. However, the SEC exempts proxy voting advice from the filing requirements if certain conditions are met.<sup>134</sup> Even if exempt, the proxy voting advice remains subject to the prohibition on false and misleading statements. Also, investment advisers required to be registered by the SEC must comply with certain disclosures, including information about any conflicts of interests.

In July 2010, the SEC published its *Concept Release on the US proxy system*. In this document, the SEC identified the conflict of interest issue for proxy advisers and included a series of questions concerning the accuracy and transparency of their advice in formulating voting recommendations. The SEC has yet to publish its final release.

#### *France*

The Autorité des Marchés Financiers (AMF) *Recommendation No. 2011-06 of 18 March 2011 on Proxy Advisory Firms* notes that the voting recommendations proxy advisers provide to shareholders can have a material impact on the passing of certain resolutions at AGMs or other general meetings.

[The AMF made a number of recommendations with a view to promoting transparency and manage conflicts of interest with the use of proxy advisers. However, these AMF recommendations are not mandatory for French-regulated entities.](#)

#### *Establishing and issuing general voting policies*

[AMF recommends that:](#)

- [proxy advisory firms should publish their general voting policies on their website](#)
- [these general voting policies should be established through a transparent process so that the opinions of investors and other market participants can be taken into consideration.](#)

#### *Issuing voting recommendations*

[AMF recommends that:](#)

- [proxy advisory firms should define the methodologies to be used by their staff for their analyses and voting recommendations to clients and publish these methodologies on their website](#)
- [proxy advisory firms should explain in their reports to clients the reasons for their voting recommendations, in particular with respect to their published general voting policies.](#)

#### *Communicating with the issuers*

[AMF recommends that:](#)

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<sup>134</sup> This exemption is granted pursuant to the Exchange Act Rule 14a-2(b)(3).

- draft reports by proxy advisers to a clients should be submitted to issuers for review. Each issuer should be given at least 24 hours to provide comments. These comments should be included in the report to a client if they are concise and help the client understand the resolution to be voted on. The final report should be sent to the issuer at the same time as it is sent to the client
- proxy advisory firms should have to correct any substantive error in their reports that is reported by the issuer
- the policy of proxy advisory firms concerning communication with issuers would be published on the firms' websites.

#### *Preventing conflicts of interest*

##### AMF recommends that:

- proxy advisory firms should define and post on their websites reasonable and appropriate measures to prevent potential conflicts of interest involving the firm, their directors and their analysts. Procedures should be specified for conflicts that arise when other activities are involved, for example, advising issuers, providing a voting platform, and proxy solicitation
- relevant measures and procedures should be included in a code of ethics or a code of conduct adopted by proxy advisory firms. A compliance officer in proxy advisory firms should be designated to ensure compliance with such codes
- proxy advisers would state in their reports to clients any ties that exist with:
  - the issuer
  - another client that is submitting items for the agenda of an issuer on which the proxy adviser is preparing a vote recommendation
  - the persons who directly or indirectly control the issuer.

#### ***European Securities and Markets Authority***

The European Securities and Markets Authority (ESMA), an independent European Union regulatory authority, has published *An Overview of the Proxy Advisory Industry: Consideration on Possible Policy Options* (March 2012) (the ESMA discussion paper).

The ESMA discussion paper builds on the work carried out by the European Commission (EC) on proxy advisers in the EC Green Paper *The EU corporate governance framework* (April 2011). The EC published a feedback statement and individual responses to the Green Paper in November 2011, noting overwhelming support (by those who provided answers to the relevant questions) for proxy advisers to be more transparent in their practices, particularly in relation to conflicts of interest.<sup>135</sup>

The ESMA discussion paper set out the observations of ESMA on a number of issues concerning proxy advisers, taking into account responses from a survey it had conducted.

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<sup>135</sup> European Commission *Feedback Statement Summary of responses to the Commission Green Paper on the EU corporate governance framework* (November 2011), answers to Question 18.

ESMA anticipates publishing a feedback statement in the latter part of 2012, which will include its view on whether there is a need for policy action in this area.

In the discussion paper, ESMA noted the role of proxy advisers and also some concerns over their influence:

ESMA considers that proxy advisors can play a constructive role in facilitating the monitoring of corporate proposals by, and lowering the information and monitoring costs for, institutional investors. This can translate into greater shareholder involvement with corporate decision making and thus to greater corporate accountability to investors.

At the same time, ESMA is aware that there exist concerns (in particular among issuers) about the use and potential overreliance by institutional investors on the voting recommendations of proxy advisors.<sup>136</sup>

ESMA also observed that most AGMs are concentrated within a certain period of the year and that:

it may be inefficient or unfeasible for an institutional investor to gather information and knowledge about every company in which it has a significant investment and it may also be difficult to attend and vote at all general meetings.<sup>137</sup>

Within this context, the discussion paper considered a number of issues concerning the role and conduct of proxy advisers.

#### *Dialogue between advisers and issuers*

Research by ESMA indicated some different approaches by advisers in Europe to the companies which they are analysing (issuers):

Typically, voting recommendations are based on publicly available information, although proxy advisers may enter into dialogue with issuers and other stakeholders, either before or during the general meeting season. The answers to the ESMA survey show that most proxy advisers engage in dialogue with the issuers at some stage of their research process and consider criticism by issuers as part of this dialogue. Engagement with issuers is being used in order to get a better understanding of company-specific issues and to enable proxy advisers to provide a more informed voting recommendation. Some proxy advisers, however, have a clear policy of not getting in touch with issuers to avoid being lobbied, being influenced, or potentially receiving inside information.<sup>138</sup>

ESMA commented that proxy advisers that do not routinely give issuers an opportunity to review their advice or otherwise engage in dialogue do so for a range of reasons, including:

- avoiding interaction during the busy AGM season, partly as a result of limited resources and partly to avoid influence through lobbying efforts by issuers
- avoiding any possibility of receiving inside information and committing potential market abuse.<sup>139</sup>

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<sup>136</sup> at paras 14 and 15.

<sup>137</sup> at para 22.

<sup>138</sup> at para 43.

<sup>139</sup> at para 81.

### *Conflicts of interest*

ESMA expressed the view in the discussion paper that, if firms providing proxy adviser services have any real influence on significant investor voting decisions, it is crucial that their advice should be independent and objective. The existence of material conflicts of interest, should they exist, potentially jeopardises this goal.<sup>140</sup>

ESMA identified a conflict if an adviser provides services to the issuer as well as to shareholders of the issuer:

A clear conflict exists when proxy advisors provide corporate ratings or other consultancy services to issuers and at the same time offer proxy research and advice to institutional clients with respect of those issuers. The risk is that proxy advisors could provide inappropriate proxy advice to investors, as they are effectively advising investors on how to read statements by issuers which they themselves may have influenced through their advice to those issuers. We have learned that in practice proxy advisors either do not provide advisory services to both issuers and investors (in respect of those issuers) or have in place a range of risk mitigation measures (though we express no view on the effectiveness of those measures at this stage).<sup>141</sup>

Other potential conflicts set out in the discussion paper include:

where an issuer or its shareholders could influence the advice proxy advisors give to investor clients because of the nature of the issuer's relationship with the proxy advisor (e.g., the proxy advisor may have some other commercial or personal relationships with the issuer or the issuer's major shareholders). Another conflict might arise when a proxy firm is part of a group in which another entity provides services with conflicting interests or if a proxy advisory firm's shareholders, directors or other related persons may have a significant interest in or serve on the boards of issuers that have proposals on which the proxy firm is offering voting advice.<sup>142</sup>

A further category of concerns referred to by ESMA arising from its survey relate to the influence that a particular investor client of the proxy adviser might have on the advice given by the proxy adviser to other investor clients, for instance:

by [the particular client] submitting to the proxy advisor its own recommendations for voting at a general meeting which the proxy advisory firm acts upon, e.g. by using it as part of the basis to develop its own voting recommendations. This could be to maintain its business relations with the [particular] investor even if it is not necessarily the best course of action for the proxy advisor for the purposes of providing objective and independent advice [to its other clients].<sup>143</sup>

ESMA commented that the conflict of interest risk may be diminished in cases where the relative influence of the proxy adviser's client is low or where investors rely on multiple proxy advisers. Also, a proxy adviser's reputation and its intellectual capital strength are vital assets to its business:

If an advisor is not behaving objectively and independently it puts these assets, its reputation and, therefore, its business at risk.<sup>144</sup>

ESMA also noted strong support from respondents for means to resolve conflicts of interest issues:

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<sup>140</sup> at para 64.

<sup>141</sup> at para 65.

<sup>142</sup> at para 66.

<sup>143</sup> at para 67.

<sup>144</sup> at para 68.

This feedback focuses on how proxy advisors may disclose information on potential conflicts of interest to their investor clients and how they manage those conflicts to ensure their advice is sufficiently objective and independent. Other suggestions go further and request for a disclosure of this information more broadly through a code of ethics or code of conduct.<sup>145</sup>

### *Transparency*

In the discussion paper, ESMA considered transparency in the way proxy advisers generate their advice as another important theme for consideration in the regulation of proxy advisers:

Transparency in general implies openness and enables informed decision-making by the parties involved. Improved transparency could be envisioned, for example, by clarity on the scope or nature of dialogue with issuers, by providing issuers with a summary of voting recommendations, or through disclosing information concerning voting policies and guidelines, the production process and methodology of the recommendations and by information on the staffing. Any measures for improved transparency should consider, among others, competition issues and commercial confidentiality issues of proxy advisors.<sup>146</sup>

### Canada

The Canadian Securities Administrators Consultation Paper 25-401 *Potential Regulation of Proxy Advisory Firms* (June 2012) was designed to provide a forum for discussion of concerns raised about the services provided by proxy advisory firms and to determine if, and how, these concerns should be addressed by Canadian securities regulators.

The paper described the role of proxy advisers in capital markets as aggregating information, providing research expertise, setting default voting standards and facilitating investor participation in shareholder meetings. The paper pointed out that institutional investors, in making their voting decisions, may use proxy advisory firms in different ways and to varying degrees and that the potential or perceived influence of proxy advisers on investors is a complex issue, with proxy advisers having a far more influential role with some shareholders than with others.

Within that context, the paper:

- identified for discussion five principal concerns raised by market participants about proxy advisers, which have been put forward as grounds for greater regulatory oversight in this area
- invited submissions on a possible regulatory approach for each of these matters, and
- identified a range of regulatory oversight frameworks, including market-based approaches.

#### 1 Potential conflicts of interest

According to the paper, a conflict of interest may exist if a proxy advisory firm provides voting recommendations to investors on corporate governance matters for which the same firm provided consulting services to the issuer. A proxy advisory firm's independence may also be compromised by conflicts arising in the ownership structure of that firm. Alternatively, an institutional client of a proxy advisory firm could be the proponent of a

<sup>145</sup> at para 70.

<sup>146</sup> at para 87.

specific shareholder proposal that could be the subject of a favourable vote recommendation by the firm.

Potential conflicts of interest may compromise the independence of vote recommendations or create a perception that the recommendation is compromised. To the extent that potential conflicts of interest are not properly identified and managed, they could be viewed as having a negative impact on the integrity of the voting process.<sup>147</sup>

The paper raised for consideration possible requirements to deal with potential conflicts of interest, whereby proxy advisory firms should:

- separate their proxy voting services from other advisory or consulting services
- design policies and procedures to identify and manage any conflicts of interest that arise in connection with the issuance of a vote recommendation, including policies to deal with any employee conflicts or ownership conflicts
- disclose the procedures to mitigate or address conflicts; disclosure to their clients of the specific conflict in the report may also be required
- review the effectiveness of such policies and procedures on a regular basis, and
- disclose the conflicts of interest policies and procedures on their websites.<sup>148</sup>

## 2 Lack of transparency

The paper commented that lack of transparency concerns appear to be a combination of both the lack of disclosure about how proxy advisory firms arrive at their vote recommendations and the lack of public disclosure of the actual report. The concern with lack of transparency is that, without that disclosure, issuers and investors may not be able to question and fully assess the quality of the information and analysis that underlie the voting recommendations, and evaluate their merits:

This could have an impact on the integrity of our capital markets. Because the proxy voting report is the product of the commercial relationship between proxy advisory firms and their clients, the report is only provided to subscribers, but the recommendations may be disclosed by subscribers, issuers or other parties to the media for strategic reasons.<sup>149</sup>

The paper noted, however, that given that the voting recommendation itself is essentially a product for which clients have paid subscription fees to obtain, it may not be appropriate to require the reports to be publicly disclosed.<sup>150</sup>

Instead, in relation to whether a regulatory response is warranted to address concerns surrounding lack of transparency, the paper requested submissions:

on whether disclosure of the analysis concerning a vote recommendation that enables an investor to assess the basis for a vote recommendation could be appropriate. We would consider requiring that proxy advisory firms disclose the internal procedures, guidelines, standards, methodologies,

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<sup>147</sup> Section 2.1.

<sup>148</sup> Section 4.1.2.

<sup>149</sup> Section 2.2.

<sup>150</sup> Section 4.2.2.

assumptions and sources of information supporting their vote recommendations. Data gathering procedures to ensure the accuracy of information could also be disclosed.

The paper also observed that consideration will have to be given to the appropriateness of requiring disclosure if the information is confidential, proprietary or cannot be disclosed for valid business purposes.<sup>151</sup>

### 3 *Potential inaccuracies and limited opportunity for issuer engagement*

The paper stated that some issuers had raised concerns about apparent inaccuracies in proxy advisers' reports, leading to misinformed voting to the extent that institutional investors significantly rely on a potentially flawed analysis underlying a vote recommendation. This concern may be especially acute in the context of complex, controversial voting matters (including M&A transactions) or closely contested voting situations.

The paper commented that:

Issuers also feel that the process for engaging with proxy advisory firms in these situations is often unclear. However, whether such inaccuracies in reports are simply differences of opinion amongst issuers and proxy advisory firms or represent misinformed recommendations remains unknown.<sup>152</sup>

The paper stated that to the extent that a regulatory response is warranted to address these concerns, it requested feedback on whether to require that proxy advisory firms have a policy to deal with issuer comments on voting recommendations and the underlying analysis:

To inform our analysis on this issue, we are requesting your feedback on whether, if we require proxy advisory firms to have a process for issuer engagement, we should also prescribe the terms of the process by which proxy advisors engage with issuers (for example, by setting specific timelines for which issuers must be given an opportunity to review a draft vote recommendation).<sup>153</sup>

### 4 *Perceived corporate governance implications*

The paper noted another concern is that proxy advisory firms may have become de facto corporate governance standard setters and that, as a result, issuers may be compelled to adopt certain 'one-size-fits-all' standards which may not be entirely suitable for their specific circumstances. However, the paper also referred to the view that this influence by proxy advisers on corporate governance practices can be beneficial to investors as it may result in the adoption of corporate governance best practices.<sup>154</sup>

In considering a possible regulatory approach, the paper commented that it may be advisable that issuers and other market participants be made aware of any corporate governance policy adopted by proxy advisory firms that may affect them:

To the extent that a securities regulatory response is warranted to address these concerns, we request your feedback on whether proxy advisory firms should implement fair and transparent procedures for developing corporate governance standards. We would suggest that the

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<sup>151</sup> Section 4.2.2.

<sup>152</sup> Section 2.3

<sup>153</sup> Section 4.3.2.

<sup>154</sup> Section 2.4.

procedures and standards be publicly disclosed. Public disclosure of the procedures may result in market participants' confidence in the standard-setting function of proxy advisors.<sup>155</sup>

### 5 Extent of reliance by institutional investors

According to the paper, certain market participants are concerned that institutional investors may rely too heavily on the vote recommendations provided by proxy advisory firms. The extent of reliance can either be complete reliance, which includes an automatic vote in accordance with a proxy advisor's recommendations, or partial reliance, where institutional investors will conduct their own research and include proxy advisors' recommendations as part of their analysis in determining how to vote.<sup>156</sup>

In regard to a possible regulatory response, the paper noted that very limited empirical information exists about how institutional investors in Canada actually use the services of proxy advisory firms and, generally, whether those investors share the concerns regarding possible over-reliance on proxy advisers.<sup>157</sup>

In consequence, the paper sought feedback on:

- how institutional investors view their voting obligations
- the extent to which various types of institutional investors rely on the services provided by proxy advisers, and
- whether institutional investors share any of the concerns about the extent of their reliance on proxy advisers or whether, from their perspective, market forces are sufficiently addressing these issues.<sup>158</sup>

### Possible regulatory oversight frameworks

The paper identified for discussion various possible ways to implement any requirements for proxy advisers in response to the concerns outlined in the paper. They included, in addition to the option of regulatory direction, various market-based approaches (in decreasing level of intervention):

- a certification framework: a designated representative of the proxy advisory firm, or a designated external party, to certify compliance with all requirements
- a comply or explain framework: the proxy advisory firm to state that it has complied with all requirements, or explain where not and, if so, why not
- best practice guidance: each proxy advisory firm to consider guidance on best practice.<sup>159</sup>

### Forthcoming report

The period for submissions has closed. Submissions are posted on the AMF website at [www.lautorite.qc.ca](http://www.lautorite.qc.ca).

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<sup>155</sup> Section 4.4.2.

<sup>156</sup> Section 2.5.

<sup>157</sup> Section 4.5.1.

<sup>158</sup> Section 4.5.1.

<sup>159</sup> Section 5.2.2.

[A report by the Canadian Securities Administrators on the matters raised in the Consultation Paper will be published in due course.](#)

### **3.3.3 Use of technology by companies to assist shareholder engagement**

[The Canadian Coalition for Good Governance report \*2012 Best Practices for Proxy Circular Disclosure\* notes that while boards may be able to meet with their largest institutional shareholders, in-person meetings are practical for engagement with all shareholders. However these limitations may to some extent be reduced by companies using innovative approaches like websites and social media to reach a broader audience. The report gave the example of a Canadian company establishing a dedicated investor relations Twitter account that is updated regularly.<sup>160</sup>](#)

## **3.4 Questions for consideration**

Submissions are invited on each of the questions set out below, or on any other aspect of shareholder engagement.

Should legislative or other initiatives (for instance, additional ASX Corporate Governance Council, or other, guidance) be adopted, and if so for what reasons, concerning:

- the role of the board collectively as it relates to engagement with institutional/retail shareholders throughout the year, including leading up to the AGM
- the role of particular board members, such as the board chair or the chairs of board committees, in relation to engagement with institutional/retail shareholders
- the role of institutional shareholders throughout the year, including leading up to the AGM. In this context:
  - is there a problem with having a peak AGM season and, if so, how might this matter be resolved<sup>161</sup>
  - should at least some institutional shareholders be required or encouraged to report on the nature and level of their engagement with the companies in which they invest, in the manner provided for in the UK Stewardship Code or otherwise
- corporate briefings
- the role of proxy advisers, including:
  - standards for investors using proxy advisers, including the extent to which these investors should be entitled to rely on the advice of proxy advisers in making voting decisions, or, alternatively, whether those investors should have some obligation to bring an independent mind to bear on these matters.
  - standards for proxy advisers
- any other aspect of shareholder engagement?

Could greater use be made of technology to promote shareholder engagement outside the AGM and, if so, how?

Should there be an amendment to the right of 100 members to call a general meeting of a company?

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<sup>160</sup> [at 26.](#)

<sup>161</sup> This matter is also considered in Section 5.3.1.



## 4 The annual report

*This chapter provides contextual information and analysis for Issue 2 of the paper. It considers the content and format of the annual report, being the principal document for consideration at the AGM that provides information for shareholders on the state of the company and the stewardship of the board. It discusses approaches and developments in Australia and elsewhere.*

### 4.1 Approaches in Australia

#### 4.1.1 Overview

The regulatory framework for annual reports in Australia involves detailed legislative prescription of various matters to be disclosed, together with more general obligations to disclose information concerning the company's performance and prospects. ASX Listing Rules, [which include the disclosure requirements in the ASX Corporate Governance Council Principles and Recommendations](#), also apply to the content of annual reports of listed entities.

Within this context, there has been industry guidance on the preparation of reports in a manner that increases their utility, particularly for retail shareholders.

There is no requirement that annual reports adopt a certain layout or method of presentation. Some concerns have been expressed, including those noted in the PJC report *Better shareholders – Better company* (June 2008) that the current requirements may not necessarily ensure that retail as well as institutional shareholders receive all relevant information in a suitable and comprehensible form.

A project to develop an integrated reporting framework, to include financial and non-financial matters, is being undertaken by the Financial Reporting Council (FRC), in conjunction with the work of the International Integrated Reporting Committee (IIRC). The FRC also has a project to reduce complexity in financial reporting.

#### 4.1.2 Regulatory requirements

##### *Corporations Act*

All companies (other than some small proprietary companies), as well as registered managed investment schemes, must prepare an annual report, comprising:

- a financial report
- a directors' report
- an auditor's report.<sup>162</sup>

A company may choose to provide this in the form of a concise report.<sup>163</sup>

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<sup>162</sup> ss 292 ff, 314(1)(a).

<sup>163</sup> s 314(1)(b), (2), (3).

Annual reports must be provided to company shareholders, either in hard copy or electronically if they so choose,<sup>164</sup> unless they elect not to be sent the information.<sup>165</sup> These reports must be provided to shareholders within certain time frames.<sup>166</sup> Annual reports must also be lodged with ASIC and thereby be accessible to the public.<sup>167</sup> The annual report must be laid before the AGM, for consideration.<sup>168</sup>

### *Financial report*

The Corporations Act prescribes the content of the financial report, including various declarations by directors and others concerning solvency and compliance with accounting standards.<sup>169</sup>

### *Directors' report*

The directors' report must include (in addition to certain specific information, including the remuneration report<sup>170</sup>):

- general information about the operation of the company, including its principal activities and outcomes during the year, and some forward-looking information<sup>171</sup>
- information to assess the operations, financial position, business strategies and future prospects of the company ([known as the operating and financial review \(OFR\)](#)).<sup>172</sup>

There is an exemption from disclosure, in either category of information, of any matter the publication of which would result in 'unreasonable prejudice' to the company.<sup>173</sup>

The obligation [to provide an OFR](#) was introduced in response to a recommendation in the HIH Royal Commission report *The Failure of HIH Insurance* (April 2003) that an OFR be included in annual reports. The Royal Commissioner referred to the proposals at that time in the United Kingdom for an OFR to contain such information as the directors decide is necessary for shareholders to obtain an understanding of the business, including details of the company's performance, plans, opportunities, corporate governance and management risks:

such a document ... would significantly assist in addressing the short-comings of audited accounts presented in accordance with the historical cost convention and other standards which can impede the utility of the accounts as a transparent assessment of the financial progress of the company.<sup>174</sup>

The Explanatory Memorandum to the Bill that introduced [the OFR requirement](#) stated that the relevant provision ([s 299A](#)) was expressed in broad terms:

- to enable directors to make their own assessment of the information needs of shareholders of the company and tailor their disclosures accordingly, and

<sup>164</sup> s 314.

<sup>165</sup> s 316.

<sup>166</sup> s 315.

<sup>167</sup> s 319.

<sup>168</sup> s 317.

<sup>169</sup> ss 295–297.

<sup>170</sup> ss 300, 300A. The content of the remuneration report was considered in the CAMAC report *Executive Remuneration* (April 2011).

<sup>171</sup> s 299.

<sup>172</sup> s 299A.

<sup>173</sup> ss 299(3), 299A(3).

<sup>174</sup> vol 1 at Section 7.2.6 and rec 13.

- to provide flexibility in form and content of the disclosures, as the information needs of shareholders, and the wider capital market, evolve over time.<sup>175</sup>

[ASIC has published a consultation paper on the OFR \(see Section 4.1.4 under ASIC\).](#)

#### *Auditor's report*

The report by an independent auditor<sup>176</sup> must indicate to shareholders whether the auditor is of the opinion that the financial report is in accordance with the statutory requirements, including the accounting standards and the requirement that the financial statements and notes in the financial report provide a true and fair view of the company's financial position and performance.<sup>177</sup>

#### *Accounting standards*

The annual financial report must comply with the accounting standards,<sup>178</sup> while the financial statements and notes must also give a true and fair view of the financial position and performance of the company.<sup>179</sup>

#### *ASX Listing Rules*

[Chapter 4 \(Periodic Disclosure\) of the ASX Listing Rules, in particular Listing Rule 4.10, sets out various matters to be included in the annual report of listed entities.](#)

[ASX Listing Rule 4.10.3 requires each listed entity to provide a statement in its annual report disclosing the extent to which the entity has followed the recommendations set out by the ASX Corporate Governance Council during the reporting period \(with reasons where the entity has not followed a recommendation, under the 'if not, why not' reporting approach\).](#)

[The ASX Corporate Governance Council \*Principles and Recommendations\* contain a range of disclosure recommendations under the various principles. A report by Chartered Secretaries Australia and Boardroom Partners \*Anything to declare?\* \(2012\) examined disclosures by the ASX top 200 listed companies in their annual reports concerning their board reviews, pursuant to Recommendation 2.5 of those \*Principles and Recommendations\*.<sup>180</sup> The report found that among those companies there was considerable variety in both the practice and the disclosure of board reviews. The report concluded:](#)

[The corporate governance statement in annual reports provides a valuable opportunity for companies to publicly exhibit their attitudes towards corporate governance. Many companies are yet to fully embrace the opportunity afforded by a disclosure that allows a company to 'tell its own story' and explain to its investors why its governance framework is aligned to their interests.](#)

[Our examination of current disclosure practices found that, while nearly all companies are formally complying, the rationale behind the disclosure requirement has not been fully embraced by some boards. It could be noted that reluctance to publicly disclose a company's governance culture is symptomatic of underlying problems within the company's attitude to accountability and stewardship. Or it may be that companies have not yet linked the change in practice and behaviour that the disclosure requirement has ushered in to the need to inform investors of such](#)

<sup>175</sup> Explanatory Memorandum to Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003, para 5.306.

<sup>176</sup> s 307C.

<sup>177</sup> s 308.

<sup>178</sup> s 296.

<sup>179</sup> s 297.

<sup>180</sup> Recommendation 2.5 is that 'companies should disclose the process for evaluating the performance of the board, its committees and individual directors.'

[changes. This disconnect between the doing and the disclosure on the part of boards is at odds with the intent of the ASXCGC recommendation, and in this regard, we hope this research provides some valuable reference.](#)<sup>181</sup>

[The report set out examples of best practice disclosure statements regarding board reviews, drawing on statements in annual reports by various UK as well as Australian listed companies. It also proposed a clarifying note from the ASX Corporate Governance Council on this matter.](#)<sup>182</sup>

ASX Listing Rule 4.10.17 requires ASX-listed entities to include in the annual report a review of operations and activities for the reporting period.

### 4.1.3 Industry guidance

[Industry guidance can seek to assist directors and others in preparing annual reports, or assist existing or prospective shareholders in understanding annual reports.](#)

#### AICD

An AICD Position Paper<sup>183</sup> sets out a series of principles, with commentary, intended to provide practical guidance to company directors and others regarding the preparation of simplified annual and other reports in a wide variety of companies, where the intended audience is mainly retail shareholders:

- Principle 1: A Simplified Report should present a balanced view
- Principle 2: A Simplified Report should be in plain English
- Principle 3: A Simplified Report should be written specifically to inform shareholders about company performance
- Principle 4: A Simplified Report should be designed to provide a clear understanding of the components of the financial results of the business, rather than just statements which comply with regulatory requirements
- Principle 5: A Simplified Report should set out key highlights
- Principle 6: Company performance should be described against stated corporate strategies, although companies should assess what level of strategic disclosure is appropriate in their circumstances
- Principle 7: Companies should consider their own circumstances when deciding whether to include financial forecasts or projections
- Principle 8: A Simplified Report should include summarised divisional reports
- Principle 9: A Simplified Report should include Reviews by the Chairman and the CEO
- Principle 10: Consideration should be given to the appropriateness of a directors' declaration and/or an auditor's report.

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<sup>181</sup> at 25.

<sup>182</sup> at v.

<sup>183</sup> AICD Position Paper No 5 *Principles of good communication with shareholders* (April 2007).

### PwC

[The Price Waterhouse Coopers \(PwC\) paper \*Corporate governance—towards best-practice corporate reporting\* \(September 2012\), though published in the UK, contains a series of general suggestions, relevant to all jurisdictions, to make disclosure documents, including the annual report, a ‘communication opportunity’ for issuers.](#)

### CPA Australia

[The CPA publication \*A guide to understanding annual reports: Listed companies\* \(October 2012\) is designed to assist existing and prospective shareholders better to understand the annual reports of listed companies.](#)

[The guide involves:](#)

- [an overview of the annual report, including an outline of its component reports and financial statements](#)
- [sample financial statements to illustrate the way in which many listed companies present yearly financial statements](#)
- [analytical steps in reading financial statements](#)
- [a glossary of terms used in annual reports.](#)

#### **4.1.4 Improving reporting**

The usefulness of the annual report, in its current format, remains controversial. For instance, a survey in 2012 by Allens Linklaters of its listed clients<sup>184</sup> indicated support from respondents for the proposition that the format and content of annual reports should be reviewed in order to make company information more accessible to investors. In noting that result, Allens Linklaters commented that:

For retail investors in particular, the annual report is the primary source of information regarding a company’s activities and strategies. However, the complexity and volume of the information can be overwhelming, leading to suggestions that companies’ reports should be made available electronically and designed in a manner that makes relevant information more accessible to investors.<sup>185</sup>

Various regulators have raised for discussion possible ways in which the current reporting requirements might be improved.

### **PJC**

The PJC report *Better shareholders – Better company* (June 2008) referred to some criticism of the current annual report requirements, particularly for retail investors.

For instance, one view expressed to the PJC was that company reports may have become inaccessible, as a consequence of mandated disclosure ‘bolt-ons’ in the Corporations Act, with the ‘concise report’ option now eroded by additional regulation.<sup>186</sup> Another respondent

<sup>184</sup> The respondents comprised board chairs, non-executive directors, chief executive officers/chief financial officers, General and Legal Counsel and Company Secretaries of various large, mid and small cap listed companies.

<sup>185</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 10.

<sup>186</sup> Chartered Secretaries Australia submission, referred to at paras 3.56-3.57.

criticised what it described as the ‘tool-kit’ approach to reports, as not containing the sort of information that investors desire:

In their current form, these reports do not address the company’s strategy, its success or failure in implementing it, or insights into what future performance might look like if the strategy is well executed ... there is little meaningful information available about how the objectives of the company are set, how risk is monitored and assessed, how performance is optimised and whether a company has the ability to create value through entrepreneurialism, innovation, development and exploration, providing accountability commensurate with the risks involved.<sup>187</sup>

Another submission expressed a preference for a principles-based, rather than a ‘black-letter’, approach to company reporting.<sup>188</sup>

The PJC concluded that:

while the CLERP 9 reforms on the electronic provision of annual reports may have saved a considerable amount of paper, the information that companies must legally provide shareholders is so dense as to be incomprehensible to most people. Evidence to the committee suggests that the concise report, which was intended to overcome some of these problems, has failed to serve its purpose. The absence of a report from companies outlining their performance and objectives in plain English represents a major barrier to retail investors engaging with companies.<sup>189</sup>

## **FRC**

### *Integrated reporting*

The FRC, through its Integrated Reporting Task Force, is monitoring the development of an international integrated reporting framework by the International Integrated Reporting Council (IIRC). Integrated reports aim to demonstrate the linkages between an organization’s strategy, governance and financial performance and the social, environmental and economic context within which it operates.

In September 2011, the IIRC published a discussion paper *Towards Integrated Reporting: Communicating Value in the 21<sup>st</sup> Century*, which considered the integrated representation of a company’s performance in terms of both financial and non-financial results.

The FRC submission to the IIRC expressed its support for an integrated reporting framework, but also noted some of the difficulties that still need to be resolved. For instance:

While stakeholders agreed that integrated reporting provides a more comprehensive picture of a company for users of financial reports; many concerns were raised – particularly in relation to the resulting compliance burden on companies, the impact it has on directors’ liability; and also the difficulty of providing the optimum level of guidance/prescription so that businesses can adapt to their specific circumstances, while enabling ease of comparability between different companies.<sup>190</sup>

Following consultation on the discussion paper, the IIRC is developing an integrated reporting framework which it intends to publish by the end of 2013. In the meantime, guidance on this form of reporting has been provided by professional bodies.<sup>191</sup>

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<sup>187</sup> Institute of Chartered Accountants submission, quoted at para 3.59.

<sup>188</sup> AICD submission, referred to at para 3.58.

<sup>189</sup> para 3.61.

<sup>190</sup> Extract from the covering letter of 15 December 2011 by the FRC Chairman in the FRC submission to the IIRC.

<sup>191</sup> See, for instance, KPMG, *Integrated Reporting: Performance insight through Better Business Reporting* Issue 2 (2012).

### *Complexity in financial reporting*

The report of the FRC Managing Complexity Task Force *Managing Complexity in Financial Reporting* (May 2012) identified various sources of financial reporting complexity:

- increasingly complex business operations
- complexities in the regulatory framework
- changing attitudes of businesses and stakeholders.

The report noted the current international work on developing integrated reporting, and welcomed this interest in improving the communication between companies, their shareholders and other stakeholders.

The report also noted that:

One particular area of complexity in financial reporting is in the presentation of results. Listed companies generally aim to provide a clear explanation of their results when they present to the market. Recognising that users may not have the necessary time, or the necessary accounting training, to fully read the financial report and analyse the result, companies often highlight key financial matters in an investor presentation.

The investor presentation is a key method that companies use to assist readers and management to manage the complexity of the financial report, and to follow movements in key items that are used to predict the future results of the company.<sup>192</sup>

The report also set out a series of suggested strategies to better manage complexity in financial reporting.

[The report requested comments from interested parties.](#)

[The FRC \*Findings from the consultation process\* \(October 2012\) summarised various themes which emerged from the consultation, including general support for better use of developments in information technology and delivery to enable users to access more efficiently their desired information. The paper also set out various recommendations based on the findings of the consultation, including support for ASIC's proposal to foster more meaningful operating and financial reviews in annual reports \(see below\).](#)

### **ASIC**

ASIC Regulatory Guide 230 *Disclosing non-IFRS financial information*, released in December 2011, is designed to encourage more meaningful communication to investors in various documents (including the Directors' Report and the Chairman's/CEO review of operations) of financial information that is presented other than in accordance with relevant accounting standards, and to assist in ensuring that the information is not misleading. ASIC has also released guidance on disclosure in remuneration reports of remuneration arrangements for directors and executives.<sup>193</sup> A remuneration report must be put to the vote of shareholders at an AGM.<sup>194</sup>

<sup>192</sup> at 7.

<sup>193</sup> 12-34MR *ASIC calls for better remuneration disclosure* (February 2012).

<sup>194</sup> s 250R(2).

In September 2012, ASIC released Consultation Paper 187 *Effective disclosure in an operating and financial review* (CP 187) proposing guidance on the operating and financial review (OFR) requirements in s 299A.

The OFR, which is part of the annual report, is required to contain information investors would reasonably require to make an informed assessment of the entity's operations, financial position, and business strategies and future prospects. It is intended to contain a narrative to supplement the information in the annual financial report (see also Section 4.1.2).

ASIC noted that while an entity's financial report provides useful information to investors about an entity's financial position and performance, it rarely provides all the information needed to readily assess the underlying drivers of the entity's financial performance and to properly understand the reasons for the entity's results, or expected future performance. An analysis of OFR reporting revealed:

- a lack of analytical information in OFRs, even though useful analytical information is provided in other documents, such as briefings to analysts
- the repetition of information in OFRs that is already contained in the entity's annual financial report without further analysis or explanation, and
- the uncertain application of the exemption in s 299A(3) which relieves entities from disclosing information about an entity's business strategies and prospects for future financial years if it would cause unreasonable prejudice to the entity.

ASIC commented that the proposed guidance:

is not intended to add unnecessary length to annual reports, but rather is intended to promote more meaningful information and analysis for investors. Encouraging good, clear, insightful information and analysis furthers ASIC's aims of promoting confident and informed investors and financial consumers and fair and efficient markets.<sup>195</sup>

Submissions on CP 187 close in November 2012, with final ASIC guidance expected in time to assist directors in complying with the disclosure requirements in s 299A for the 30 June 2013 annual reporting season.

ASIC has also undertaken work, through its MoneySmart website, to assist retail readers of annual reports to use these effectively.

### *Australian Government*

The Australian Government *Options paper: use of standard business reporting (SBR) for financial reports* (November 2012) canvasses various options for the use of Standard Business Reporting for the lodgement of financial reports, including as part of annual reports.

SBR uses an international business reporting language called eXtensible Business Reporting Language (XBRL). The elements of SBR, XBRL, and iXBRL are explained in the paper.<sup>196</sup>

As stated in the paper:

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<sup>195</sup> ASIC media release 12-228MR.

<sup>196</sup> Attachments 1 and 2.

SBR simplifies the business-to-government reporting process by providing standardised electronic reporting. It is based on the idea that information will be 'recorded once, reported to many' to enhance business efficiency. SBR works as a by-product of day-to-day business systems, allowing businesses to report through a single online channel to government directly from these systems. SBR offers an easier and more convenient way for businesses to report to government, saving time, minimising compliance costs and providing greater certainty.<sup>197</sup>

The paper examines issues concerning the use of SBR for the lodgement of financial reports, including whether, in the interests of business efficiency and to enhance the transparency of financial reports, this form of reporting should be mandatory or voluntary. Currently, entities regulated by ASIC may choose to lodge their financial reports with ASIC using SBR-enabled software.

Submissions on the proposals in the paper are sought by March 2013.

## 4.2 Approaches in the United Kingdom

### 4.2.1 Overview

Considerable attention has been given in recent years to matters concerning the content and method of presentation of the annual report, prompted in part by concerns raised by the global financial crisis.

In addition to the statutory requirements and those in the UK Corporate Governance Code, the FRC and the UK Department for Business Innovation and Skills (BIS) have published a number of papers that have considered various aspects of the content and presentation of annual reports. In so doing, the FRC has noted that:

The annual report is the main channel of communication from the company to its shareholders, the market and other stakeholders. It is therefore in companies' own interests to give a clear and balanced account of their performance and position and - in the corporate governance statement - of how the board carries out its role and how shareholder interests are safeguarded.<sup>198</sup>

### 4.2.2 Legislation

The UK *Companies Act 2006* requires that all companies other than small companies produce a business review, as part of the directors' report in the annual report.<sup>199</sup>

The stipulated purpose of the business review is to inform shareholders and help them assess how the directors have performed their duty under s 172 of the Act to promote the success of the company.<sup>200</sup> Another reason is to promote forward-looking narrative reporting by companies, covering risks as well as opportunities.<sup>201</sup>

The business review must contain a fair review of the company's business and a description of the principal risks and uncertainties facing the company. It must include a balanced and comprehensive analysis of the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year.

<sup>197</sup> at iv.

<sup>198</sup> FRC *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) at 15.

<sup>199</sup> s 417. The general requirements for the directors' report in the annual report are set out in ss 415-419.

<sup>200</sup> s 417(2).

<sup>201</sup> UK Department of Trade and Industry Press Release, 8 November 2006.

With listed companies, the business review must identify the main trends and factors likely to affect the future development, performance and position of the company's business.

There are various exemptions from disclosure, including impending developments or matters in the course of negotiation if, in the opinion of the directors, such disclosure would be seriously prejudicial to the interests of the company.

### 4.2.3 The UK Corporate Governance Code

This 'comply or explain' Code, developed by the FRC, contains a range of specific requirements concerning the content of the annual report. This includes a requirement, introduced in 2010, that the directors:

include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.<sup>202</sup>

The FRC noted in a subsequent review of the Corporate Governance Code that:

It was felt that an explanation of the way in which the company believes it will generate value over the longer term would enable shareholders and other users of the report to come to a more informed view about whether the company's strategy would deliver that value, and the extent to which the company understood and was addressing the main risks to that strategy.<sup>203</sup>

The FRC also observed that while companies have attempted in their annual reports to describe their business models:

Companies will need to experiment and innovate to discover how best to convey their business models in a way that resonates with readers. This is why business model reporting has been identified as a priority project for the new Financial Reporting Lab [see Section 3.2.4 *Innovation in reporting*].<sup>204</sup>

[The most recent edition of the Corporate Governance Code, which commenced in October 2012, expanded on the pre-existing requirement that the directors should explain in the annual report their responsibility for preparing the annual report and accounts, by also requiring that the directors:](#)

[state that they consider the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's performance, business model and strategy.](#)<sup>205</sup>

[According to the FRC:](#)

[These simple requirements are a polite reminder that a narrative report is not merely a marketing document, but should complement the figures in the financial accounts, to provide a clear and coherent portrayal of the progress of the business.](#)<sup>206</sup>

<sup>202</sup> Section C.1.2 of the UK Corporate Governance Code. The full set of specific requirements for the annual report in this Code is summarised in Schedule B of the Code under the heading *The UK Corporate Governance Code*.

<sup>203</sup> FRC, *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) at 17.

<sup>204</sup> id at 18.

<sup>205</sup> [Provision C.1.1.](#)

<sup>206</sup> [FRC, Speech by Baroness Hogg, Chairman of the FRC Board, NAPF Conference, 22 November 2012.](#)

#### 4.2.4 Unnecessary information in annual reports

##### **FRC**

In June 2009, the FRC published *Louder than Words: Principles and actions for making corporate reports less complex and more relevant*. That paper argued that the primary purpose of the annual report is to provide shareholders with information that is useful for assessing the stewardship of the board and management and for making their future investment decisions. However, assessing a company's performance and prospects can be made more difficult if key relevant information in an annual report is obscured by information 'clutter' (otherwise known as 'kitchen sink' reporting), which may result in important messages being lost.

The FRC used the term 'clutter' to refer to immaterial disclosures in an annual report that inhibit the ability of shareholders to identify and understand relevant information, as well as explanatory information that remains unchanged from year to year.

In April 2011 the FRC followed up with a paper *Cutting clutter: Combating clutter in annual reports*. In the accompanying press release, the Accounting Standards Board of the FRC observed:

Clutter in annual reports is a problem, obscuring relevant information and making it harder for users to find the salient points about the performance of the business and its prospects for long-term success.

The paper set out a series of practical suggestions for persons preparing annual reports, to reduce unnecessary information in those reports.

##### **BIS**

A UK Department for Business Innovation and Skills (BIS) paper *The future of narrative reporting: Consulting on a new reporting framework* (September 2011) referred to the problem of annual reports containing 'clutter' in the form of information that remains unchanged from year to year:

Many of the disclosures currently required in the annual report relate to policies and procedures which would not necessarily change from one annual report to the next. The Government is keen to facilitate a leaner annual report, and believes that it should be possible to include sets of data into the Annual Directors' Statement by a cross reference or link to where the additional data can be accessed.<sup>207</sup>

The paper noted that:

In order to ensure that such data is regularly reviewed and, where necessary, updated, the Government believes that directors should be required to review this information annually. We believe that this is best achieved by requiring directors to confirm in the Annual Directors' Statement that they have reviewed, and where necessary updated, the information included by cross reference and should describe any significant changes.<sup>208</sup>

##### **FRC**

[Following on from its earlier discussion paper \*Louder than Words\* \(2009\), the FRC paper \*Thinking about disclosures in a broader context\* \(October 2012\) aims to improve the quality of information disclosed in annual reports and to curtail a piecemeal approach to reporting.](#)

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<sup>207</sup> para 3.30.

<sup>208</sup> para 3.31.

In particular, the paper covers the reduction of ‘clutter’ in reports by avoiding duplication in disclosures and using tests of materiality more rigorously. Its proposed ‘road map’ for a disclosure framework is structured around four questions:

- what information do users need: the aim is to ensure that disclosures are relevant and targeted to the needs of users
- where should disclosures be located: the aim is to develop placement criteria to provide structure for the financial report so that disclosures are organized in a way that is more informative to the reader and can be consistently applied
- when should a disclosure be provided: the aim is to reduce the disclosure burden through the application of the concepts of proportionality and materiality
- how should disclosures be communicated: the aim is to develop a set of principles for good communication that will assist in improving the quality of disclosures.

A consultation period runs until early 2013.

#### 4.2.5 Necessary information in annual reports

In January 2011, the FRC published *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*, aimed at improving the dialogue between company boards and their shareholders in response to lessons of the global financial crisis.

In relation to annual reports, the FRC paper had various proposals including that:

- directors should take full responsibility for ensuring that an annual report, viewed as a whole, provides a fair and balanced report on their stewardship of the business<sup>209</sup>
- directors should describe in more detail the steps that they take to ensure:
  - the reliability of the information on which the management of a company (and therefore their stewardship of the company) is based, and
  - transparency about the activities of the business and any associated risks<sup>210</sup>
- companies should take advantage of technological developments to increase the accessibility of the annual report and its components, such as eXtensible Business Reporting Language (XBRL) [www.xbrl.org], being a tagging system that would enable persons to find more quickly specific items of data in an annual report. The XBRL system has been mandated by the SEC for the lodgement of MD&A documents.<sup>211</sup>

<sup>209</sup> at 10.

<sup>210</sup> at 10.

<sup>211</sup> at 11. See also the KPMG paper *The Journey to Better Business Reporting* (2011) which refers to the role that technological innovations such as XBRL can play in improving business communications to the market. The paper noted the view that:

the benefits to XBRL will come in the future when tagged information is readily available from all companies and can be accessed electronically for analysis, benchmarking, reporting uses and financial modelling. Not only can XBRL enhance external financial reporting, but it can also be applied internally for cost accounting, performance measurement, analysis and decision-making purposes (at 10).

Table 1 of the paper sets out a summary of the XBRL taxonomy (at 12).

The FRC paper pointed out that its proposals would result in additional requirements on directors, including forward-looking statements of belief or judgement. As a result, those persons may seek some form of ‘safe harbour’. The paper stated that the FRC would support the provision of a ‘safe harbour’ defence to the extent that persons provide assurance in relation to forward-looking statements, and provided that such statements or judgements were not made recklessly, dishonestly or fraudulently.<sup>212</sup>

In September 2011, the FRC published *Effective company stewardship: next steps*. This paper set out a summary of actions the FRC intends to take in light of responses to its January 2011 document *Effective Company Stewardship: Enhancing Corporate Reporting and Audit*. A number of matters covered in the September 2011 paper concern the annual report (as set out below).

#### 4.2.6 Narrative reporting

##### *FRC*

The September 2011 FRC paper *Effective company stewardship: next steps* referred to the importance of the annual report in enabling investors and others to determine whether a company can create and sustain value over the short, medium and/or long term. It also referred to the importance of narrative reporting in the annual report:

Following the [global] financial crisis, there has been a growing recognition that narrative reporting has not received the same focus as financial reporting and this has led to calls for a new, holistic approach where the [annual] report provides a concise overview of a business, its strategic objectives, the challenges that it faces and any other information that stakeholders need to enable them to make an informed assessment of a business’s ability to create and sustain value.<sup>213</sup>

The paper referred to the publication by the UK Department for Business Innovation and Skills (BIS) *The future of narrative reporting: Consulting on a new reporting framework* (September 2011) (see below). The FRC indicated that it will coordinate with the BIS review, and will:

test further whether there is sufficient support for the development of a narrative reporting standard which would apply on a comply or explain basis where appropriate.<sup>214</sup>

The FRC paper also discussed how a company’s exposure to risk could best be described in a narrative report:

the FRC has concluded that in future narrative reports, companies should:

- focus primarily on strategic risks - rather than those risks that arise naturally and without action by the company (such as volcanic interruptions of air travel or earthquake damage) and
- disclose these risks and the major operational risks inherent in their business model and their strategy for implementing that business model, explaining how they will address those risks and any obstacles that may be encountered as a result of changes in the business environment.

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<sup>212</sup> at 18.

<sup>213</sup> at 6.

<sup>214</sup> at 8.

The FRC considers this would be more consistent with directors' legal duty to focus on the principal risks and uncertainties facing the company, rather than producing indiscriminate lists of all the risks companies face.<sup>215</sup>

In regard to the presentation of risk information in an annual report:

The FRC believes that any description of the risks a company faces should not be made difficult to assess by being scattered about the annual report. Consequently, if a company considers that the risks it faces are best understood if discussed in the context of the company's strategy, those risks should also be included in the company's description of principal risks in the Business Review (section 417, Companies Act 2006).<sup>216</sup>

A subsequent FRC paper reported progress by companies in their reporting of risks:

with a number of companies including tables in their reports setting out the company's strategic objectives and/or key performance indicators, the main risks to achieving those objectives and how those risks are being mitigated. This is by no means the only way in which this information can be integrated, and the content of these tables is sometimes fairly limited, but it illustrates that it can be done relatively simply.<sup>217</sup>

### ***BIS: Development of strategic report concept***

The UK Department for Business Innovation and Skills (BIS) consultation paper *The future of narrative reporting: Consulting on a new reporting framework* (September 2011) (the September 2011 BIS paper) proposed a new annual reporting framework for quoted UK companies.

The paper pointed out that previous consultations had indicated a common view that annual reports may have become too long and complex and that change to the current annual reporting framework for these companies is both desirable and needed:

Preparers and users want it to be easier to draw out strategic company information from the increasing volume of published company data and for a more coherent framework for that data, whether required or offered voluntarily. In essence company reports need to become relevant to their key audiences once more.<sup>218</sup>

### ***Strategic report and annual directors' statement***

The paper proposed the replacement of the current directors' report, which includes the business review (see Section 4.2.2 of this CAMAC paper), with a Strategic Report and an Annual Directors' Statement.

The intention is that the Strategic Report will provide a clear, concise overview of the business of the company, its strategy, its business model, performance and key financial data, significant changes to governance and the directors' views of the challenges, opportunities and risks facing the company. The Annual Directors' Statement would provide more detailed, comparable information for analysts and others to use:

The Strategic Report will be where the board sets out and signs off the strategy, direction and challenges facing the company, evidenced by high-level financial and remuneration information. This report will provide a clear line of sight from the

<sup>215</sup> at 10.

<sup>216</sup> at 11.

<sup>217</sup> FRC, *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) at 18.

<sup>218</sup> para 2.4.

strategy, business model and risks of the company to the financial results and the resulting rewards for the company's directors.

This will be supported by detailed information in an Annual Directors' Statement presented in a consistent and coherent format aimed at online publication. This will be much clearer for users to follow and will provide a platform from which future developments (for example, tagging narrative information to make it more searchable) can be implemented. A prescribed structure with a set layout and standard headings will increase comparability for users and provide a helpful check-list of required disclosures for companies.

Companies will also be able to include voluntary disclosures (for example on social and environmental issues) in the Annual Directors' Statement, increasing the visibility of this information and making the Annual Directors Statement the key source of detailed information on specific aspects of company performance.<sup>219</sup>

A summary of the proposed content of the Strategic Report was set out in Annex B of the September 2011 BIS paper.

In regard to the interaction of the two reports, the paper pointed out that:

The Strategic Report will be more concise than the existing narrative report, and will cross-refer to the detailed information in the Annual Directors' Statement, thereby facilitating access to more detailed information on a particular topic for those requiring it ... In contrast to the Strategic Report, the Annual Directors' Statement will be the repository for reporting requirements which are required disclosures irrespective of materiality or impact on the business as a whole.<sup>220</sup>

A subsequent BIS paper *The future of narrative reporting: The Government Response* (March 2012) (the March 2012 BIS paper) indicated strong support from respondents for the proposal. They considered that the business model was the key piece of information for the report and that, when combined with the information about strategy and risks, it would give shareholders a clear picture of the challenges faced by the company.<sup>221</sup>

The March 2012 BIS paper indicated that the BIS will work with the FRC, in consultation with sector representatives, to clarify the detail of the Strategic Report and to establish the full breadth of information that should go into the Annual Directors' Statement whilst ensuring that they do not create duplication. The intent is:

to develop a format that is flexible enough to allow companies to tell an integrated story in their own words, starting with their business model and strategy, covering their performance and looking towards their future.<sup>222</sup>

### *Sign off*

The September 2011 BIS paper noted that:

In order to ensure that the board of directors takes responsibility for the new Strategic Report, the Government is proposing that the report should be signed by each individual director as well as the company secretary. This should encourage the whole board to take ownership of the report, and will contribute to its status as key company document.<sup>223</sup>

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<sup>219</sup> paras 1.4-1.6.

<sup>220</sup> paras 2.12-2.13.

<sup>221</sup> at 6.

<sup>222</sup> at 4.

<sup>223</sup> para 3.21.

The March 2012 BIS paper indicated strong opposition from respondents to the proposal that the Strategic Report should be signed off by each director individually. It was argued that the proposal is unnecessary as the board is already collectively responsible for the content of the annual report and requiring individual directors to sign the report might undermine that collective responsibility.<sup>224</sup>

### *Liability*

The September 2011 BIS paper commented that issues of liability for statements made in a company's annual report are an important factor in the quality of disclosures made in that report, particularly in the provision of forward-looking information. However, this may not pose a problem for directors:

Under the current regime, directors are liable for any reckless or fraudulent misstatements made in the Directors Report. The Government believes that the current framework provides protection for users from malpractice, while enabling directors to make statements about the future (for example on risk) which, necessarily, have an element of uncertainty.<sup>225</sup>

The March 2012 BIS paper indicated differing views by respondents as to whether the UK liability regime discouraged meaningful forward-looking statements:

Those who did think that this was a problem were concerned that statements are perceived as commitments and that directors may be wary of exposure if presenting facts that have a reputational risk or contain elements of commercial confidentiality.<sup>226</sup>

### **BIS: implementation of strategic report concept**

The BIS paper *The future of narrative reporting* (October 2012) set out draft amendments to the UK *Companies Act 2006* to introduce a Strategic Report, to replace the business review in the annual report. The obligation will apply to quoted companies (being companies incorporated in the UK and listed on certain UK, EU or US securities markets) and will come into force in October 2013. There will be an exemption for small companies.<sup>227</sup> Annual reports will also need to include the Annual Directors' Statement.

The purpose of the Strategic Report is to allow shareholders, in a concise, stand-alone report, to find out about a company's business model and strategy, the risks it faces, how it is performing and the direction in which it is heading.<sup>228</sup> The FRC will consult in 2013 on providing guidance on these requirements.

The directors will have a duty to prepare the Strategic Report,<sup>229</sup> which will need to be approved by the board of directors and be signed on behalf of the board by a director or the company secretary.<sup>230</sup> If an approved Strategic Report does not comply with the statutory requirements, those directors who were aware of this non-compliance or were reckless as to whether it complied, and failed to take reasonable steps to secure compliance or to prevent the report being approved, are personally liable.<sup>231</sup>

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<sup>224</sup> at 7.

<sup>225</sup> para 4.19.

<sup>226</sup> at 10.

<sup>227</sup> Proposed s 414B.

<sup>228</sup> Proposed s 414C.

<sup>229</sup> Proposed s 414A.

<sup>230</sup> Proposed s 414E.

<sup>231</sup> Proposed s 414E.

#### 4.2.7 Web and printed annual reports

The FRC paper *Effective company stewardship: next steps* (September 2011) noted that:

- there was widespread opposition to the proposal that companies only post their annual report on their websites, rather than also produce them in print. Removal of hard copy reports would disadvantage shareholders with limited access to the Internet. Many small shareholders pointed out that they find it easier to read and annotate a hard copy report and to compare it with others
- there was concern that online-only information could be altered after publication. Hard copy reports provide an important safeguard against such behaviour.<sup>232</sup>

The September 2011 BIS paper observed that:

The detailed information required in the Annual Directors' Statement is best suited to presentation online ... The ability to link and cross reference the material in the Annual Directors' Statement to the Strategic Report and the financial statements will also enable the reader to readily drill down into the detail, should they wish to do so ... The Government is not proposing to change the law with respect to a shareholder's right to require the company to provide 'hard copies' of company reports ... However we anticipate that increasingly the Annual Directors' Statement will be primarily designed for digital access, while retaining the right of shareholders to access the printed versions ... The Government's aim is that the proposed new framework will be adaptable enough to accommodate future requirements in corporate reporting (such as iXBRL5).<sup>233</sup>

The March 2012 BIS paper indicated strong support from respondents for enabling companies to include material in the Annual Directors' Statement (for instance, information on policies and procedures) by cross-reference to information published elsewhere (for example, on the company's website).<sup>234</sup> Respondents also agreed that the Annual Directors' Statement should be presented online, with a hard copy available to shareholders only on request.<sup>235</sup>

#### 4.2.8 Innovation in reporting approaches

The FRC paper *Effective company stewardship: next steps* (September 2011) noted strong support in the consultation process for the creation of a Financial Reporting Laboratory (FRL) in which companies could discuss and trial new approaches to reporting with regulators and investors.

In late 2011, the FRC established the FRL. The FRC website sets out the following ways in which the FRL can help meet contemporary reporting needs:

- as a learning space, companies can use the Lab to test new reporting formats with investors, and investors can indicate areas where management can add greater value through the information they provide
- as a hub to support innovation in reporting, the Lab's focus on gathering and sharing evidence from the market provides the broader corporate community with feedback from shareholders on the value that new reporting formats bring.<sup>236</sup>

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<sup>232</sup> at 7.

<sup>233</sup> paras 3.7-3.11.

<sup>234</sup> at 8.

<sup>235</sup> at 8-9.

<sup>236</sup> FRC website: *The Financial Reporting Lab*.

## 4.3 United States

### 4.3.1 Information overload

The issue of possible disclosure overload and complexity in annual reports and other documents provided by companies to shareholders has been given increasing consideration in recent years.

For instance, in 2008 the SEC announced a project, *the 21st Century Disclosure Initiative*, to develop approaches to advance the transparency and clarity of financial and other disclosures. The Financial Accounting Standards Board (FASB) is also undertaking initiatives to improve the efficiency and effectiveness of financial statement disclosures by focusing on matters that are most important to users of a particular entity's financial statements. The desired result is a reduction in disclosure volume, offset by an increase in the utility of the information disclosed. The FASB intends to issue a discussion document on this matter.

The KPMG and Financial Executives Research Foundation report *Disclosure overload and complexity: hidden in plain sight* (2011) observed that annual reports filed by US companies are increasingly complex and that disclosure complexity affects both users and preparers:

Investors are concerned with longer and more opaque annual reports.<sup>237</sup>

In this context:

It is becoming a concern that the proliferations of required disclosures that accompany financial reports make it difficult to decipher a company's performance and factors that drive performance.<sup>238</sup>

The report made a number of disclosure recommendations relevant to the annual report:

The SEC should issue an interpretive release to address the permissibility of cross-referencing and manner of addressing immaterial items to reduce redundant and unnecessary disclosures.

Summaries of significant accounting policies and discussions of newly implemented or soon to be implemented accounting policies should be streamlined to eliminate unnecessary redundancy and patently immaterial disclosures.

Preparers should expand their use of tabular and graphic information delivery formats.

The SEC should move forward with its 21st Century Disclosure Project to enable greater use of technology to avoid unnecessary repetition of information in multiple filings.

The FASB should accelerate consideration of the Disclosure Framework to establish a systemic approach to disclosure that properly balances disclosure considerations.

Preparers should confine disclosure of risk factors to company specific unique risk factors as contemplated by Item 503(c) of Regulation S-K.

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<sup>237</sup> at 10.

<sup>238</sup> *ibid.*

The FASB and SEC should undertake incremental procedures to ensure that there is an appropriate and adequate cost-benefit analysis in support of all new disclosure requirements. This should include expanded field testing of disclosure proposals.<sup>239</sup>

#### 4.4 Questions for consideration

Submissions are invited on each of the questions set out below, or on any other aspect of the annual report.

Should legislative or other changes be adopted, and if so for what reasons, concerning any aspect of the annual report requirements?

In this context:

- do the current reporting requirements produce any unnecessary information (‘clutter’) in annual reports and, if so, how might this be reduced
- should the reporting requirements be redesigned in any respect, including along any of the lines adopted, or under consideration, in overseas jurisdictions, such as having a strategic report and an annual directors’ statement
- what, if any, issues of liability might arise in the event of changes to the reporting requirements, particularly in relation to forward-looking statements, and how might this matter be dealt with
- how might technology best be employed to increase the accessibility of annual reports
- what, if any, initiatives might be introduced to cater for future innovations in reporting (for instance, would it be beneficial to establish the equivalent of a Financial Reporting Laboratory)?

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<sup>239</sup> at 3, 38-40.



## 5 Conducting the AGM

*This chapter considers a series of matters concerning the conduct of an AGM under its current functions and format, as part of Issue 3 of the paper.*

### 5.1 Ambit of the chapter

The discussion in this chapter is based on the current functions and format of the AGM. The possible future of the AGM, and what changes to the functions and format of the meeting this may involve, are discussed in Chapter 6.

Some of the legislative provisions and other matters referred to in this chapter are equally applicable to other shareholder meetings. However, the analysis and questions raised in this chapter are formulated in terms of AGMs.

The chapter notes, but does not raise questions concerning, the provisions for voting on the remuneration report, the two-strikes rule and the ‘no vacancy’ provisions concerning board positions. These matters involve recent policy decisions by the Government, which this paper does not seek to reopen.

### 5.2 Regulatory overview

The AGM process for listed public companies is regulated through:

- the Corporations Act and regulations
- the ASX Listing Rules
- the ASX Corporate Governance Principles
- the company constitution, and
- general law principles.

In addition, various industry bodies provide guidance on the procedures for conducting an AGM.

#### 5.2.1 Legislation

Chapter 2G of the Corporations Act regulates the calling and conduct of AGM and other shareholder meetings. Some of the provisions apply to all shareholder meetings, while others are specifically directed at AGMs. Also, some provisions are mandatory while others are replaceable rules and therefore apply unless displaced or modified in a company’s constitution.<sup>240</sup>

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<sup>240</sup> s 135.

There are various other provisions in the Corporations Act that regulate specific matters that may be dealt with at an AGM.<sup>241</sup>

In regard to the statutory procedural requirements for an AGM, the general principle is that the court can ensure that procedural irregularities will not invalidate proceedings at the AGM, unless the court considers that substantial injustice has occurred.<sup>242</sup>

### 5.2.2 ASX Listing Rules

The ASX Listing Rules cover meetings for listed entities, including the convening of and voting at meetings, and voting exclusions.<sup>243</sup> The Listing Rules also impose various voting requirements,<sup>244</sup> and require disclosure to the ASX of the outcome of each resolution put to a meeting of shareholders.<sup>245</sup>

### 5.2.3 Corporate Governance Principles

Principle 6: *Respect the rights of shareholders* of the ASX Corporate Governance Council *Principles and Recommendations* refers to the use of company meetings as a means to promote effective communication with shareholders. Listed companies must provide a statement in their annual report disclosing on an ‘if not, why not’ basis the extent to which these principles and recommendations have been followed.<sup>246</sup>

### 5.2.4 Company constitutions

The constitution of a company may include provisions that can materially affect the voting process, to the extent that the constitution includes provisions in substitution for replaceable rules.

### 5.2.5 General law

Various procedural matters concerning an AGM, in particular the powers and duties of the chair in conducting the meeting, are largely governed by common law principles.

### 5.2.6 Industry guidance

Guidance on various aspects of conducting AGMs is provided by industry bodies. This includes *Guide to Procedures at AGMs* and *Guidelines on managing voting exclusions on remuneration-related resolutions*, published by Chartered Secretaries Australia, and *Annual General Meetings*, published by the AICD.

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<sup>241</sup> See, for instance, Part 2D.3 Div 1 Subdiv B, dealing with declarations by a board of ‘no vacancy’ in board positions.

<sup>242</sup> s 1322. The case law on some of the general principles in this section, such as how a court might deal with deliberate procedural irregularities and what constitutes substantial injustice are summarised in *Chalet Nominees (1999) Pty Ltd v Murray* [2012] WASC 147 at [17] ff and *Woolworths Limited v GetUp Limited* [2012] FCA 726 at [18]ff. See also *Northwest Capital Management v Westate Capital Ltd* [2012] WASC 121. In regard to the application of s 1322 to passing resolutions at shareholder meetings, see *Scullion v Family Planning Assn of Queensland* (1985) 10 ACLR 249; *Talbot v NRMA Holdings Ltd* (1996) 139 ALR 755; *Cordiant Communications (Australia) Pty Ltd v Communications Group Holdings Pty Ltd* [2005] NSWSC 1005 at [87].

<sup>243</sup> ASX Listing Rules Chapter 14.

<sup>244</sup> See, for example, ASX Listing Rules 6.8–6.9.

<sup>245</sup> ASX Listing Rule 3.13.2.

<sup>246</sup> ASX Listing Rule 4.10.3 and ASX Listing Rules Guidance Note 9.

[In addition, periodic publications, including Ernst & Young \*Equipping the board for the AGM\* \(September 2012\), identify issues for each AGM season, as well as providing more general guidance on conducting an AGM.](#)

## 5.3 Calling the AGM

### 5.3.1 Timing

Public companies must hold an annual general meeting at least once in each calendar year and within five months after the end of their financial year, unless ASIC grants an extension or exemption.<sup>247</sup>

In practice, most companies conduct their AGM in the latter part of each calendar year. This concentration of AGMs can place particular demands on those institutional investors with shares in a number of companies, who may need to settle their views and voting intentions on matters that will come up for consideration at AGMs within a short time frame. For this purpose, these investors may need to place considerable reliance on analysis provided by proxy advisers or others.

According to one commentary, a proposal to extend the permissible period for holding AGMs would:

serve to give companies more flexibility in managing the timing for holding their AGM, so as, for example, to avoid the congestion of the ‘AGM season’ that is currently experienced. The overall period required for carrying out the process – in terms of when it starts and when it ends – would not change, so costs and other burdens should not be increased. The proposal may, in fact, lower costs; eg by reducing the competition for meeting venues over a relatively short period.<sup>248</sup>

Likewise, the CSA/Blake Dawson (now Ashurst Australia) discussion paper *Rethinking the AGM* (2008) suggested that:

extending the statutory period for holding the AGM by one month, and therefore providing a three-month window for the interaction of shareholders with directors instead of the current two-month window, could improve shareholder engagement and participation. This paper does not suggest that any extension should be granted to companies to present their results to shareholders beyond that already contained in the Corporations Act.<sup>249</sup>

### Question

Should there be any change to the statutory time frame for holding an AGM?

<sup>247</sup> ss 250N, 250P, 250PAA, 250PAB. ASIC Regulatory Guide 44 *Annual general meeting -- extension of time* deals with the circumstances in which ASIC will grant an extension of time for an AGM. ASIC Regulatory Guide 174 *Externally administered companies: Financial reporting and AGMs* indicates that ASIC’s policy is not to take enforcement action against a public company in liquidation which does not hold an AGM and also deals with the circumstances in which ASIC may grant an extension of time for externally administered companies. See also ASIC 12-225MR *Info sheet on financial reporting compliance of insolvent public companies* (September 2012).

<sup>248</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 13.

<sup>249</sup> Section 4.3.

### 5.3.2 Notice of meeting

Any notice of the AGM must be sent to all shareholders<sup>250</sup> (as well as to directors and the auditor)<sup>251</sup> at least 28 days in advance for listed companies<sup>252</sup> and must, at a minimum:

- set out the place, date and time for the meeting<sup>253</sup> (and the technology to be used if the meeting is to be held in two or more places<sup>254</sup>)
- state the general nature of the meeting's business
- if a special resolution is to be proposed at the meeting - indicate that fact and state the resolution
- provide information concerning proxy appointment rights
- for listed companies, inform shareholders that the resolution concerning the remuneration report will be put at the AGM and, if a 25% 'no' vote on the resolution would be the second strike under the two-strikes rule, explain that such a vote would lead to a spill resolution at the AGM for the removal of directors and the appointment of persons to fill the resulting vacancies.<sup>255</sup>

The information included in the notice of meeting must be worded and presented in a clear, concise and effective manner.<sup>256</sup> In addition, directors are under a common law duty to provide such material as will fully and fairly inform the shareholders of what is to be considered at the meeting and to enable them to make a properly informed judgment on the matters in question. The material provided should be intelligible to shareholders who are not versed in business matters. However:

The obligation to make full and fair disclosure does not oblige the directors to give shareholders every piece of information that might conceivably affect their voting. The adequacy of the information provided in documentation is to be assessed in a practical, realistic way having regard to the complexity of the proposal.<sup>257</sup>

The notice must disclose any benefits that directors will obtain as a result of the passing of any resolution.<sup>258</sup>

Attachment A of the ASX Corporate Governance Council *Principles of Good Corporate Governance and Best Practice Recommendations* (1<sup>st</sup> edition, 2003) contained guidelines for notices of meetings.

<sup>250</sup> s 249J. The company must maintain a register of its members: ss 168(1)(a), 169.

<sup>251</sup> ss 249J, 249K.

<sup>252</sup> s 249HA.

<sup>253</sup> The meeting must be held at a reasonable time and place: s 249R. See further *Coombs v Dynasty Pty Ltd* (1994) 14 ACSR 60; *Smith v Sadler* (1997) 15 ACLC 1,683, *Howard v Mechtler* [1999] NSWSC 232; *Colbern Nominees Pty Ltd v Prime Minerals Ltd* [2009] WASC 289.

<sup>254</sup> Section 249S permits the use of video conference or other technology for AGM and other shareholders' meetings, whereby shareholders can attend the meeting at more than one location.  
s 249L.

<sup>255</sup> s 249L(3).

<sup>256</sup> *ENT v Sunraysia* [2007] NSWSC 270 at [19]. The relevant common law principles on disclosure are analysed at [14]-[22] and [25] of that decision.

<sup>257</sup> *ENT v Sunraysia* [2007] NSWSC 270 at [19]. The relevant common law principles on disclosure are analysed at [14]-[22] and [25] of that decision.

<sup>258</sup> These common law principles are discussed in HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (loose leaf, LexisNexis Butterworths) at [7.460].

The Australian law is in accordance with the recommendations in the *OECD Principles of Corporate Governance* (2004) for notices of meeting to contain full and timely details of company meetings and the questions to be decided at them.<sup>259</sup>

### Canadian ‘notice and access’ approach

Much of the cost associated with an AGM can involve the distribution of documents to shareholders, particularly by post. To streamline the process, and reduce the cost, of providing information to shareholders, Canada has adopted a ‘notice-and-access’ mechanism whereby issuers may deliver proxy-related materials for annual and other shareholder meetings by placing the relevant information circular and other materials on a non-SEDAR website<sup>260</sup> and then sending a ‘notice package’ advising shareholders that proxy-related materials have been posted and explaining how to access the material.

The notice package sent to shareholders must explain the notice-and-access process in plain language, contain certain basic information about the shareholder meeting and matters to be voted on, and explain how to obtain paper copies of the information circular, if desired. The notice package may be sent by mail or may be forwarded by electronic means to any shareholder who has consented to receiving this information through the internet.<sup>261</sup>

### Questions

In what respects, if any, might the requirements for information to be included in the notice of meeting for an AGM be supplemented or modified?

How might technology be used to make this notice more useful to shareholders?

Might any other documents usefully be sent with the notice of meeting, and, if so, what?

### 5.3.3 Notice to shareholders holding shares through nominees

Bearer shares, which would permit shareholders to remain anonymous, are not permitted.<sup>262</sup> Nevertheless, investors may choose to hold their shares through nominees for various reasons. Only the nominee is entered in the share register.<sup>263</sup> Currently, companies are only required to send shareholder information to the nominee.

The CASAC Report considered whether there should be a specific legislative procedure for companies to communicate directly with the beneficial owners of shares held by nominees, for the purpose of the AGM or otherwise.<sup>264</sup> The Report concluded that such legislative procedures were unnecessary,<sup>265</sup> as:

<sup>259</sup> Principle II.C.1 states: ‘Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.’ See also Principle II.A(3), which states that: ‘Basic shareholder rights should include the right to ... obtain relevant and material information on the corporation on a timely and regular basis.’

<sup>260</sup> [www.sedar.com](http://www.sedar.com) is the official site that provides access to most public securities documents and information filed by public companies and investment funds with the Canadian Securities Administrators.

<sup>261</sup> Ontario Securities Commission, *Canadian Securities Administrators adopt amendments to improve issuer communications with investors* 29 November 2012. Further details for registered shareholders are set out in National Instrument 51-102 *Continuous Disclosure Obligations* and for beneficial owners of shares in National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*.

<sup>262</sup> s 254F.

<sup>263</sup> s 1072E(10).

<sup>264</sup> paras 2.33-2.43.

<sup>265</sup> CASAC Report para 2.43, rec 4.

- persons have the choice of being registered as shareholders, and thereby receiving information directly from the company, or holding their shares through nominees
- if they choose the latter approach, they can make their own arrangements with the nominee concerning the receipt of that information
- many shareholders holding their shares through nominees would be sophisticated investors, who do not need specific legislative protection of this nature, and
- compliance with any mandatory notification requirements could impose too great an administrative burden on companies.

A different approach is taken in Canada. In that jurisdiction, reporting issuers, and some other entities, may send documents concerning the affairs of the issuer, including annual reports, financial statements and other proxy-related material, directly to beneficial owners of the reporting issuer's securities if the beneficial owner does not object to having beneficial ownership information (including that person's contact information and securities holdings) disclosed to the reporting issuer or other entity.<sup>266</sup> The issuer is to be advised on these matters by the nominee registered shareholder, pursuant to the instructions of the beneficial owner to that shareholder.<sup>267</sup> The securities legislation restricts the use of beneficial ownership information to matters relating to the affairs of the reporting issuer.

Amendments operating from February 2013<sup>268</sup> are designed to enhance communication between a reporting issuer and disclosed beneficial owners, including by:

- allowing greater use of the internet for the delivery of proxy-related material, pursuant to the 'notice and access' mechanism<sup>269</sup>, thereby reducing the volume of documents otherwise sent to disclosed beneficial owners
- simplifying the process by which beneficial owners themselves may attend at shareholder meetings and vote the shares over which they have a beneficial entitlement.

## Questions

Should there be provisions for companies to send information about an AGM directly to the beneficial owners of shares held by nominees and, if so, what type of information?

Should there be any provision for beneficial owners of shares in a company to participate in the AGM of that company and, if so, how?

<sup>266</sup> National Instrument 54-101 *Communication with Beneficial Owners of Securities of a Reporting Issuer*.

<sup>267</sup> Form 54-101F1 *Explanation to clients and client response form*.

<sup>268</sup> Ontario Securities Commission *Canadian Securities Administrators adopt amendments to improve issuer communications with investors* 29 November 2012.

<sup>269</sup> The Canadian 'notice-and-access' mechanism, as also referred to in Section 5.3.2 of the CAMAC paper, permits reporting issuers to deliver proxy-related materials by placing them on a website and sending a notice package to disclosed beneficial owners as well as registered shareholders. The notice package must include a plain-language explanation of how the notice-and-access system operates and how proxy-related materials can be accessed online or by paper copy. A reporting issuer can send this notice package to a disclosed beneficial owner electronically, rather than by post, where the beneficial owner has given prior consent to this form of communication.

## 5.4 Shareholders placing matters on the AGM agenda

### 5.4.1 Overview

It has long been the right of shareholders who satisfy a threshold test to require the company to circulate any proposed resolution put forward by them on which shareholders lawfully may vote at an AGM or other shareholder meeting and any statement concerning that resolution. This gives proponents the opportunity to bring a matter to the attention of other shareholders and seek their support before shareholders decide whether to attend the AGM or how to complete their proxies.<sup>270</sup> This shareholder right may also act as a counterbalance to the common law right of the directors to circulate their views to shareholders on matters for consideration at the AGM at the company's expense.<sup>271</sup>

Several issues arise in this process:

- the shareholding threshold for requiring a resolution or statement to be considered at the AGM (Section 5.4.2)
- the timing requirements for these resolutions or statements (Section 5.4.3)
- the rules governing excluded material (Section 5.4.4)
- the consequences of failing to present a resolution at the AGM (Section 5.4.5), and
- whether shareholders should be permitted to put forward non-binding resolutions relating to matters outside their powers (Section 5.4.6).

### 5.4.2 Threshold for placing matters on the AGM agenda

With some exceptions (see Section 5.4.4), a company must distribute to all shareholders, at its own cost, any notice of resolution or any shareholder statement concerning that resolution which it has received within the requisite period (see Section 5.4.3) from at least 100 shareholders or shareholders representing 5% of the total votes that can be cast by shareholders.<sup>272</sup>

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<sup>270</sup> The Canadian Dickerson Report (1971) at paras 274, 276 commented that the purpose of permitting shareholders to propose resolutions was:

to provide a shareholder with machinery enabling him, at the expense of the corporation, to communicate with his fellow shareholders on matters of common concern. At common law, the management of a corporation is under no obligation to make any reference in any of the documents sent out by it to any non-management view of the matters discussed ... nor to include in a notice of meeting any proposals other than its own ... This places shareholders wishing to have a matter discussed at a meeting at a severe disadvantage because the meeting cannot effectively do anything not fairly comprehended by the notice of meeting.

[The legislation] ... is based upon the proposition that shareholders are entitled to have an opportunity to discuss corporate affairs in general meeting, and that this is a right and not a privilege to be accorded at the pleasure of management.

<sup>271</sup> The common law duty of directors to inform shareholders of proposals to be considered at a shareholders meeting gives the board an opportunity to put forward its point of view. At common law, directors who honestly believe that the policy they are promoting is in the best interests of the company may use company funds to circulate relevant information to shareholders, except for information that supports or opposes in a partisan way particular candidates for election as directors. In consequence, 'the ability [of directors] to use the machinery and money of the company to make their views known to the members places the directors in a strong position compared to that of members who are critical of the board's policy': J Farrar & B Hannigan, *Farrar's Company Law* (4th edition, Butterworths, 1998) at 314. See also HAJ Ford, RP Austin & IM Ramsay, *Ford's Principles of Corporations Law* (loose leaf, LexisNexis Butterworths) at [7.460].

<sup>272</sup> ss 249N-249P. The 100 shareholder threshold may be altered by regulation for a particular company or a particular class of company: ss 249N(1A), 249P(2A).

On one view, the right of 100 shareholders (regardless of the number or value of shares held by each shareholder) to propose resolutions to be circulated at the company's expense may enable shareholders who represent only a very small economic interest in the company to have a considerable influence over the AGM agenda and therefore the business to be conducted at that meeting.

The *OECD Principles of Corporate Governance* (2004) support shareholders having the opportunity 'to place items on the agenda of general meetings, and to propose resolutions, subject to reasonable limitations'.<sup>273</sup> However, the OECD principles also considered it reasonable, 'that in order for shareholder resolutions to be placed on the agenda, they need to be supported by shareholders holding a specified market value or percentage of shares or voting rights'.<sup>274</sup>

The CASAC Report recommended that:

- the current prerequisites for shareholders to move resolutions at meetings of listed public companies should remain
- however, for the purpose of the 100 shareholders test, each of those shareholders should be required to hold shares of a meaningful economic value, say, \$1,000 (as measured by the highest market value in the 12 months prior to giving the company the notice of the resolution).<sup>275</sup>

The Business Council of Australia Discussion Paper *Company + Shareholder Dialogue: Fresh approaches to communication between companies and their shareholders* (2004) also considered that the 100 shareholder test should be supplemented by a requirement that each shareholder hold at least a minimum economic interest of some nature. The paper stated that:

Requiring shareholders to have a minimum economic interest helps ensure that shareholders calling for general meetings or placing resolutions on the agenda of AGMs have a genuine investment in the company.<sup>276</sup>

### Question

Should there be any change to the threshold tests for shareholders placing matters on the agenda of an AGM?

#### 5.4.3 Timing requirements

Shareholders seeking to put resolutions on the agenda for the AGM must give at least two months' notice of their intention to do so.<sup>277</sup> From one perspective, this relatively long notice period is necessary for logistical reasons in preparing for the AGM. However, as explained below, companies could reduce the opportunity for shareholders to put resolutions on the

<sup>273</sup> Principle II.C.2.

<sup>274</sup> Annotation to Principle II.C.2.

<sup>275</sup> rec 5. By contrast, the Committee concluded that the threshold test for shareholders to call an extraordinary meeting of the company should be tightened by removing the 100 shareholder criterion and restricting the right to call a meeting to shareholders who, collectively, have at least 5% of the votes that may be cast at a general meeting: rec 2.

<sup>276</sup> Section 4.1.2.

<sup>277</sup> s 249O(1).

agenda by announcing the date for holding the AGM less than two months before the meeting date.

Directors may call the AGM on a minimum 28 days' notice,<sup>278</sup> though they must also comply with relevant Listing Rules (concerning nominations of directors<sup>279</sup>). If less than two months' notice is given:

- shareholders are effectively precluded from that point from having any proposed resolution in response to that notice considered at that AGM, rather than at a subsequent shareholder meeting<sup>280</sup>
- shareholders must bear the costs of circulating any of their statements in response to any matter raised in the notice of the meeting, unless the meeting resolves otherwise.<sup>281</sup>

The CASAC Report recommended that:

- all listed public companies be required (in the listing rules or, failing that, in the corporations legislation) to give the relevant Exchange (for public release) at least three months' notice of the date of their next AGM
- there be discretionary powers to permit companies to reschedule their meetings, or shorten the notice period, in appropriate circumstances.<sup>282</sup>

One policy option is to require that all public companies publicly give in excess of two months' notice of the date of the next AGM, indicating in the pre-agenda notice:

- the cut-off date for shareholders to place items on the agenda and to have any statements concerning that item circulated to shareholders
- the cut-off date for nominations for the position of director.

There could be a minimum stipulated period (say, one month) after the notice is published to lodge resolutions and statements, and notify nominations. To reduce costs, that notice could be published only on the company's website, provided it was given prominence.

The formal notice of meeting would not be circulated until after the cut-off dates.

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<sup>278</sup> ss 249CA, 249HA (these sections apply to meetings generally, not just the annual general meeting).

<sup>279</sup> ASX Listing Rule 14.3 requires that a listed entity must accept nominations for the election of directors up to 35 business days before the date of a general meeting at which directors may be elected (in the case of a meeting that members have requested directors to call, the period is 30 business days), unless the company's constitution provides otherwise.

<sup>280</sup> The effect of s 249O(1) is that any draft resolution prepared by shareholders can only be considered at the next general meeting that occurs *more than two months* after the notice of that resolution is given. An important exception is s 203D(2), which permits shareholders to pass a resolution to remove a director where the company calls a meeting after notice of the resolution is given to the company, even though the meeting is held less than two months after the notice of resolution is lodged.

<sup>281</sup> Under s 249P(8), shareholders seeking distribution of their statements are 'jointly and individually liable for the expenses reasonably incurred by the company in making the distribution if the company does not receive the statement in time to send it out with the notice of meeting. At a general meeting, the company may resolve to meet the expenses itself.' The company is not obliged to circulate any statement received after notice of the meeting has been sent unless the relevant shareholders first provide the funds: s 249P(7), (9)(b).

<sup>282</sup> rec 6.

## Questions

Should there be any change to the timing requirements for the calling of an AGM, including for shareholders to place matters on the agenda of an AGM, to seek the circulation of statements concerning any resolution, or to nominate persons for the position of director?

Should companies be required to publish a pre-agenda notice and, if so, what should be the contents and timing of that notice?

### 5.4.4 Excluded material

At common law, directors may refuse to distribute a proposed resolution if its object cannot be lawfully achieved at the meeting, for instance, if it deals with a matter of management exclusively vested in the directors,<sup>283</sup> or is void for uncertainty.<sup>284</sup> However, shareholders may be able to circumvent this right of refusal by appropriately drafting the resolution.<sup>285</sup>

A company need not distribute a resolution or statement that is more than 1,000 words long or defamatory.<sup>286</sup> It has been held that the word ‘defamatory’ in this context is given its usual meaning at common law, namely, whether the meaning of the publication in question ‘has a tendency to lower the plaintiff in the estimate of the ordinary reasonable reader’, and without consideration of the availability of defences, such as substantial truth and public interest.<sup>287</sup> In that case, the Court held that:

a reader could draw the conclusion [from the statement] that a person charged with carrying out some functions for the [company] had advanced his own interests in an improper way. That is the sort of conclusion which would result in the material being defamatory. As well, it seems to me that the ordinary reader of the material could draw from it, and indeed would be likely to draw from it, a conclusion that particular directors had engaged in a cover up. That is a course of action which would be in breach of their directors’ duties and it seems to me that likewise the statement is defamatory for that reason.<sup>288</sup>

In upholding the right of the directors to exclude the statement on the grounds of defamation, the court also recognised that:

in a case such as the present, where there is a requisition to remove directors, freeing a company of an obligation to circulate a statement which is defamatory will to some extent stifle the debate.<sup>289</sup>

<sup>283</sup> *Isle of Wight Railway Co v Tahourdin* (1883) 25 Ch D 320, *Scott v Scott* [1943] 1 All ER 582, *NRMA Ltd v Parker* (1986) 11 ACLR 1, 4 ACLC 609, *Stanham v The National Trust of Australia (New South Wales)* (1989) 7 ACLC 628, 15 ACLR 87, *NRMA Limited v Bradley* [2002] NSWSC 788.

<sup>284</sup> *NRMA Ltd v Parkin* [2004] NSWCA 153.

<sup>285</sup> For instance, the resolution could propose the removal of one or more directors who oppose a particular social agenda or the alteration of the constitution to require directors to take into account particular social policies. The powers to alter the constitution or remove directors are given to the shareholders in general meeting: ss 136, 203D. Companies may seek to prevent shareholders from using this stratagem by amending their constitutions. E Boros and J Duns, *Corporate Law* (2nd edn, Oxford University Press, 2010), at 50, noted that:

In 2004, Boral Ltd inserted a novel kind of ‘further provision’ in its constitution, which operated at the point of proposing the special resolution to alter the constitution rather than at the point of voting on it, and required that it first be approved either by a resolution of the board or by 5% of shareholders.

<sup>286</sup> s 249P(9)(a). *Re Harbour Lighterage Ltd* (1968) 1 NSWLR 439, *NRMA Ltd v Snodgrass* [2002] NSWSC 811 at [22].

<sup>287</sup> *NRMA Ltd v Snodgrass* [2002] NSWSC 811, at [10]-[20].

<sup>288</sup> at [23].

<sup>289</sup> at [19].

The common law test is objective, in contrast with the comparable New Zealand provision, which contains a subjective test that permits directors to exclude information that they consider to be defamatory.<sup>290</sup>

### Question

Does the current law concerning excluded material either create undue difficulties for shareholders who wish to criticise directors or, conversely, unduly restrict directors in vetting out information to be circulated to shareholders at the company's expense?

#### 5.4.5 Consequences of failing to present a resolution at a meeting

In the United States, the SEC rules require that at least one of the shareholders proposing a resolution, or the shareholder's representative, attend the meeting to present the proposal. If a proposing shareholder or representative fails to attend without good cause, the company is permitted to exclude all proposals from the proposing shareholder for any meetings held in the following two calendar years.<sup>291</sup>

The CASAC Report did not favour a similar restriction in Australia, as:

- there was no identified problem in this area in Australia
- in Australia, unlike the US where a single shareholder can propose a resolution, the proposing of a resolution requires at least 100 shareholders, or shareholders representing 5% of the issued voting share capital. All these shareholders would be prevented from putting forward any further resolution for the relevant period.<sup>292</sup>

### Question

Should there be any rule regarding the failure to present a resolution at an AGM?

#### 5.4.6 Non-binding shareholder resolutions

Shareholders may only pass binding or non-binding resolutions on matters within their power under the Corporations Act, under relevant Listing Rules or under the company's constitution.<sup>293</sup> They have no power to pass valid resolutions on any other matters, particularly those within the exclusive jurisdiction of the board of directors.

The CASAC Report considered whether shareholders should have a general power to consider and pass non-binding resolutions (in addition to specific non-binding resolutions provided for in the legislation). It noted that a general power to propose non-binding resolutions:

<sup>290</sup> The *New Zealand Companies Act 1993* First Schedule clause 9(6) permits directors to exclude any part of a proposal or resolution prepared by a shareholder that the directors consider to be defamatory (within the meaning of the *Defamation Act 1992*) or any part of a statement prepared by a shareholder that the directors consider to be defamatory (within the meaning of the *Defamation Act 1992*), frivolous, or vexatious.

<sup>291</sup> SEC Exchange Act Release No 40018, 21 May 1998 *CCH Federal Securities Law Reporter Transfer Binder* 1998 at ¶86018 p 80,556.

<sup>292</sup> para 3.49, rec 7.

<sup>293</sup> See footnote 5 in the CASAC Shareholder Participation Report.

- may assist shareholders to participate in the company’s affairs by allowing them to pass resolutions on a wide range of matters, and thereby enhance their influence over a company’s decisions
- would provide shareholders with an opportunity to express their opinions formally on any aspect of the company’s operations and, to this extent, reinforce the notion of managerial responsibility to shareholders.<sup>294</sup>

However, the CASAC Report did not support giving shareholders this general power to pass non-binding resolutions, arguing that it could:

- blur the fundamental distinction between the role of the board of directors and that of the general meeting. Company boards may feel obliged to take non-binding resolutions into account, notwithstanding that the shareholders bear no legal responsibility for them
- diminish director accountability by enabling directors to avoid responsibility for their decisions on the basis that a non-binding resolution authorised their actions
- put pressure on directors to disclose confidential commercial information to shareholders who propose such resolutions
- be contrary to the OECD observation that a company cannot be effectively run through shareholder plebiscite or other forms of shareholder micro-management.<sup>295</sup>

The CASAC Report also noted that shareholders who have sufficient voting power to pass a non-binding resolution could equally promote their point of view by replacing the current directors with their own appointees, given that directors of a public company can be removed at any time by ordinary resolution of shareholders.<sup>296</sup>

### Question

Should shareholders have greater scope for passing non-binding resolutions at AGMs?

## 5.5 Questions from shareholders prior to the AGM

### 5.5.1 Opportunity to ask questions

In practice, companies tend to communicate with their major investor groups, including institutional shareholders, on an ongoing basis, providing them with an opportunity to raise issues or concerns independently of the AGM process. These discussions can assist companies in preparing the chairman and CEO addresses to the AGM and the resolutions to be put to the AGM.

Subject to particular provisions dealing with the auditor of the company (see Section 5.5.2, below), a company may seek the views of other shareholders on issues they would like discussed at the AGM. For this purpose, a company may choose to invite shareholders to submit written questions, electronically or otherwise, prior to the AGM and may prepare written responses to some or all of those questions, or include responses in the addresses at the AGM. However, a company is not obliged to provide this opportunity or to answer

<sup>294</sup> para 3.57.

<sup>295</sup> para 3.56, rec 8.

<sup>296</sup> s 203D. See para 3.58 of the CASAC Shareholder Participation Report.

shareholders' questions, nor is there a standard process for dealing with any questions received. However, any price-sensitive information a company does provide in response to a question would be subject to the continuous disclosure requirements.<sup>297</sup>

### 5.5.2 Questions to the auditor

The *OECD Principles of Corporate Governance (2004)* state that:

Shareholders should have the opportunity to ask questions to the board, including questions relating to the annual external audit.<sup>298</sup>

Shareholders who are entitled to vote at an AGM have the right to submit written questions to the company auditor dealing with the content of the auditor's report that is to be considered at the AGM or the conduct of the audit of the annual financial report that is to be considered at the AGM.<sup>299</sup> The company must, as soon as practicable thereafter, pass the questions to the auditor.<sup>300</sup> The auditor is required to prepare a list of the questions received that the auditor considers relevant to the content of the auditor's report or the conduct of the audit of the company's financial report.<sup>301</sup> The company must, at or before the start of the AGM, make copies of that list reasonably available to members attending the meeting.<sup>302</sup>

The auditor must attend the AGM or arrange for a suitable qualified representative to do so.<sup>303</sup> The chair must provide shareholders as a whole with a reasonable opportunity to question the auditor on various matters.<sup>304</sup> The auditor has a right to be heard at the AGM,<sup>305</sup> but is not obliged to speak or to answer written questions.<sup>306</sup> The auditor has qualified privilege if he or she chooses to do so.<sup>307</sup>

### 5.5.3 Proposal

The Business Council of Australia Discussion Paper *Company + Shareholder Dialogue: Fresh approaches to communication between companies and their shareholders (2004)* observed that calling for questions prior to an AGM allows the company to ensure the board and chief executive can provide at the AGM the information and answers sought by the shareholders.<sup>308</sup>

The BCA paper outlined a possible next step as being to add the top identified issues formally to the AGM agenda as separate items for discussion (but not for voting), so that the agenda for the AGM would broadly consist of two parts:

- the formal business of the meeting (on which shareholders may vote) and

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<sup>297</sup> Corporations Act Chapter 6CA and ASX Listing Rule 3.1.

<sup>298</sup> Principle II.C.2.

<sup>299</sup> s 250PA.

<sup>300</sup> s 250PA(3).

<sup>301</sup> s 250PA(4)-(8).

<sup>302</sup> s 250PA(9).

<sup>303</sup> s 250RA.

<sup>304</sup> s 250T.

<sup>305</sup> s 249V.

<sup>306</sup> Paragraph [5.230] of the Explanatory Memorandum to the CLERP 9 Bill, which introduced s 250PA, stated that the omission of any requirement to answer was deliberate, as such a requirement would have elevated the status of written questions above that of questions asked orally at the meeting.

<sup>307</sup> s 1289.

<sup>308</sup> Section 3.1.2.

- specific issues raised by shareholders (on which shareholders may not vote).<sup>309</sup>

The agenda might also provide for a discussion of ‘Other Business’ (or the chairman could simply allow a general discussion from the floor at the conclusion of the formal business of the meeting), to allow any matters that have not already been raised and discussed to be considered at the conclusion of the AGM.<sup>310</sup>

The BCA paper observed that this order of business would also prevent discussion of the matters that are subject to a formal shareholder resolution being distracted by prior discussion of other matters.

### Questions

What, if any, additional legislative or best practice procedures should be adopted for companies to seek the views of shareholders on issues they would like discussed at the AGM, or to invite shareholders to submit questions prior to the AGM?

Should there be some obligation on the auditor (or the representative of the auditor) to speak at the AGM?

What, if any, obligations should a company or a company auditor have to answer questions from shareholders?

## 5.6 Business of the AGM

The business of an AGM is set out in the notice of meeting. It may also include any of the following, even if not referred to in the notice of meeting:

- the consideration of the annual financial report, directors’ report and auditor’s report (which the directors must lay before the AGM<sup>311</sup>)
- the election of directors
- the appointment of the auditor
- the fixing of the auditor’s remuneration.<sup>312</sup>

There are also provisions concerning voting on the remuneration report and the operation of the two-strikes rule on those reports.

The content of any prepared announcement, including any prepared address by the chair, that will be delivered at the AGM must be provided to the ASX no later than the start of the meeting.<sup>313</sup> If other material information is released at the meeting, the company must immediately inform the ASX.<sup>314</sup>

It is open to a company to include on the AGM agenda any other matter that requires a shareholder resolution. In practice, however, significant matters concerning the reorganization of a company that require shareholder approval, such as changing the

<sup>309</sup> Section 3.1.2.

<sup>310</sup> *ibid.*

<sup>311</sup> s 317.

<sup>312</sup> s 250R(1).

<sup>313</sup> ASX Listing Rule 3.13.3.

<sup>314</sup> ASX Listing Rule 3.1.

company's capital structure, approving changes in corporate control or entering into members' schemes of arrangement, may be considered by way of an extraordinary general meeting, convened particularly for that purpose.

While shareholders as a whole must be given a 'reasonable opportunity' at an AGM to ask questions or make comments on the management of the company,<sup>315</sup> they do not have an equivalent legislative right to discuss a resolution before it is put to the vote.

## Questions

Should any matter be excluded from or, alternatively, added to the business of the AGM?

## 5.7 Chairing the AGM

### 5.7.1 Overview

The directors may elect an individual to chair the AGM (a replaceable rule).<sup>316</sup> The chair conducts the business of the meeting.

In general terms, the role of the chair involves settling the procedures for the meeting and ways of dealing with procedural motions, settling any disputes about voting procedures and otherwise deciding points of order, ensuring that the sense of the meeting is properly ascertained (including by putting proposed resolutions to the vote), declaring the result of voting on a resolution, adjourning the meeting if appropriate, and closing the meeting.<sup>317</sup>

A chair can preside at a meeting, even where it will cover matters on which the chair has a personal interest.<sup>318</sup>

The position and powers of the chair are also affected by the constitution of the company, as well as by statutory provisions (see below).<sup>319</sup>

### 5.7.2 General functions and duties

#### Outline

The legislation contains some references to the general powers and obligations of the chair, for instance:

- to allow a reasonable opportunity for the shareholders as a whole at the meeting to ask questions about or make comments on the management of the company<sup>320</sup>
- to allow a reasonable opportunity for the shareholders as a whole at the meeting to ask questions about or make comments on the remuneration report<sup>321</sup>

<sup>315</sup> ss 250S, 250T.

<sup>316</sup> s 249U. In *Carpathian Resources Ltd v Hendriks* [2011] FCA 41 a dispute arose as to which person had been validly appointed pursuant to the terms of the company's constitution to chair an AGM. The court held that the meeting had fallen into complete disarray and should be treated as adjourned.

<sup>317</sup> See generally, *National Dwelling Society v Sykes* [1894] 3 Ch 159 at 162; *Corpique (No 20) Pty Ltd v Eastcourt Ltd* (1989) 7 ACLC 794.

<sup>318</sup> *Atkins v St Barbara Mines Ltd* (1996) 22 ACSR 187, (1997) 15 ACLC 800.

<sup>319</sup> See, for instance, s 250K(2).

<sup>320</sup> s 250S.

<sup>321</sup> s 250SA.

- to allow a reasonable opportunity for the shareholders as a whole to question the auditor, or his or her representative, and provide a reasonable opportunity for the auditor or representative to answer written questions submitted before the meeting.<sup>322</sup> An auditor or a representative is obliged to attend an AGM,<sup>323</sup> but is not under a statutory obligation to answer questions<sup>324</sup>
- to determine objections to a person's right to vote<sup>325</sup>
- to vote proxies according to their terms<sup>326</sup>
- to declare the results of a vote on a show of hands<sup>327</sup>
- to demand a poll<sup>328</sup>
- to determine when and how to conduct a poll on a matter when validly demanded by the chair or other shareholders<sup>329</sup>
- to adjourn the meeting in appropriate circumstances.<sup>330</sup>

The chair has a degree of discretion about how to exercise these powers and obligations and otherwise perform the role of conducting the AGM.

### *Provide an opportunity for shareholders to ask questions or comment*

In regard to providing shareholders with a reasonable opportunity to ask questions or make comments, the use of the words 'as a whole' was intended to confirm that each individual shareholder does not have a right to ask a question. Rather, what constitutes a 'reasonable

<sup>322</sup> ss 250PA, 250T. In answering questions, the auditor has qualified privilege: s 1289.

<sup>323</sup> s 250RA.

<sup>324</sup> Paragraph 250T(1)(b) provides an opportunity for the auditor to answer questions, but not an obligation to do so.

<sup>325</sup> s 250G (a replaceable rule).

The courts may overrule a chair's ruling. In *Link Agricultural Pty Ltd v Shanahan* (1998) 16 ACLC 1,462, 28 ACSR 498, the Victorian Court of Appeal ruled that the purpose of the powers conferred on the chair with respect to the conduct of a poll is to facilitate the voting and the counting of votes in order that the will of the majority of shareholders should be reliably ascertained. A chair's ruling to disallow particular proxies would be invalid if made in bad faith or for an ulterior or impermissible purpose or if the irregularity relied on by the chair was so minor that it could not justify excluding the votes. This decision could be seen as a significant precedent for courts being prepared to set aside attempts to disallow proxies on purely technical, rather than substantive, grounds. Cf *Industrial Equity v New Redhead Coal Company Limited* [1969] 1 NSW 565.

<sup>326</sup> s 250BB(1)(c).

<sup>327</sup> s 250J(2) (a replaceable rule).

<sup>328</sup> s 250L(1)(c).

<sup>329</sup> s 250M(1) (a replaceable rule). The purpose of the powers conferred upon the chair with respect to the conduct of the polls is to facilitate the voting and counting of the votes upon the relevant resolutions in order that the will of the majority of members, eligible to vote and voting, should be reliably ascertained: *Link Agricultural Pty Ltd v Shanahan & Ors* [1998] VSCA 3 at [40], cited in *Western Ventures Pty Ltd v Resource Equities Ltd* [2005] WASC 53 at [29].

<sup>330</sup> At common law, the power to dissolve or adjourn meetings rests with the shareholders. In addition, s 249U(4) (a replaceable rule) provides that the chair must adjourn a meeting of the company's shareholders if the shareholders present with a majority of the votes at the meeting agree or direct the chair to do so. However, the chair also has power to adjourn the meeting where it is impractical for the shareholders to pass a resolution, for instance, where unruly conduct prevents the continuation of business or the venue is not large enough for all those entitled to attend to take part in the debate and to vote. In exercising that power, a chair must act in good faith and reasonably in light of the purposes for which the power exists. See *John v Rees* [1970] Ch 345, *Byng v London Life Association Limited* [1989] 1 All ER 560. See also J Farrar & B Hannigan, *Farrar's Company Law* (4th edition, Butterworths, 1998) at 319.

Where a meeting is adjourned and a resolution is passed at the resumption of that meeting, it is treated as having been passed on the day the meeting was resumed: s 249W.

opportunity’ will depend on the circumstances of the meeting, and these rights given to shareholders are not intended to affect the chairperson’s power to run an orderly meeting.<sup>331</sup>

It is not clear whether, in providing this reasonable opportunity, a chair could impose any time, or other, limits on an individual shareholder speaking at the AGM.

### ***Providing an opportunity for shareholders to discuss a proposed resolution***

There is case law for the proposition that the chair is under an obligation to provide some opportunity for shareholders to discuss a resolution before a vote is taken. The chair:

\_\_\_\_\_ should not terminate debate on a substantive resolution over objection, unless he is satisfied that there has been a reasonable opportunity for the arguments on each side of the question to be put. The chairman is not bound to accept a motion for the closure of debate unless he is so satisfied.<sup>332</sup>

Also, it does not matter that a majority of shareholders at the meeting may wish to foreclose the debate:

\_\_\_\_\_ The [minority] are nevertheless entitled to a reasonable opportunity to have their points of view ventilated.<sup>333</sup>

However, it does not suffice that the court may conclude that it would have exercised the chair’s discretion in some other way:

\_\_\_\_\_ The law recognises that in a purely procedural matter such as the control of debate, the chairman must of necessity have considerable latitude of action in making decisions which will bind those present.<sup>334</sup>

Therefore:

\_\_\_\_\_ the court will not interfere unless the exercise of that discretion can be shown to be invalid, e.g. on the ground that it was exercised in bad faith.<sup>335</sup>

The CSA/Blake Dawson (now Ashurst Australia) discussion paper *Rethinking the AGM* (2008) raised the question whether there should be a minimal designated period for the deliberative function of the AGM, similar to the obligation to provide a reasonable opportunity for shareholders as a whole to ask questions and comment on the management of the company.<sup>336</sup>

### ***Demanding a poll***

The chair can demand a poll on any resolution.<sup>337</sup> At common law, the chair is under a duty ‘to ascertain the sense of a meeting on any resolution properly coming before the meeting’,<sup>338</sup> including by requiring a poll where necessary for that purpose. As observed in

<sup>331</sup> The Explanatory Memorandum to the *Company Law Review Act 1998*, para 10.78.

<sup>332</sup> *Re Direct Acceptance Corp Ltd* (1987) 5 ACLC 1,037 at 1,041.

<sup>333</sup> *ibid.*

<sup>334</sup> *id* at 1,041–1,042.

<sup>335</sup> *id* at 1,041.

<sup>336</sup> Section 4.1.g.

<sup>337</sup> s 250L(1)(c).

<sup>338</sup> In *Re Bomac Batten Ltd & Pozhke* [1984] 1 DLR (4d) 435, a Canadian Court held that the chair was obliged to hear both sides of any debate or argument before reaching any conclusion or ruling. In *Wishart v Henneberry* [1962] 3 DLR 171 at 173, the Court said: ‘The chairman of a meeting of a particular body, however, is bound by the rules of that body and cannot refuse to put motions which are in order under those rules. It is his duty to put those motions in order to ascertain the sense of the meeting.’

one leading case, and notwithstanding that the power to call a poll is frequently conferred on a chairman in apparently unfettered terms:

it is clear that the power is to be exercised not according to the chairman's personal desire or preference but to ensure that the true will of the membership is discovered on the particular proposal.<sup>339</sup>

According to one commentary, the consequence of applying that principle would be:

to invalidate a resolution where the chair, while aware that there are sufficient proxies against the motion that it would be defeated on a poll (whether the proxies are held by the chair or someone else), allows a vote to go forward on a show of hands, and the resolution is accordingly passed. The principle would also apply in the converse situation, where the chair allows the motion to be defeated on a show of hands, while nevertheless aware that proxies in favour of the motion would carry it on a poll, although in that case the remedy to address the wrongdoing would have to be differently framed.<sup>340</sup>

That commentary also discussed the circumstance where the failure of a chair to call for a poll is not determinative of whether the motion is carried, but nevertheless a vote on a poll would have a particular significance not present on a show of hands. This situation can arise where a chair is aware that, on a poll, more than 25% of the votes will be against the resolution to approve the remuneration report, thereby activating the first or second strike under the two-strikes rule.<sup>341</sup>

We think there is a plausible argument for the view that, in a context where negative votes of at least 25% are given legislative significance, the chair's duty to ascertain the true will of the shareholders extends to ascertaining whether 25% or more of the shareholders are opposed to the resolution.<sup>342</sup>

### *Other discretions*

On one view, the principles concerning the chair's duty to call for a poll are just one aspect of a wider duty, to exercise all of the powers vested in the chair of a meeting in good faith and for the purpose for which they are conferred:

The main role of the chair is to ensure that the sense of the meeting is ascertained in relation to any question properly before it. Therefore, when considering whether to exercise any procedural powers which he or she holds (such as the powers to adjourn the meeting, accept or reject motions from the floor, and maintain order), the chair should make decisions impartially for the purpose of identifying the best course of action to find the collective will of the members on all matters properly before the meeting.<sup>343</sup>

<sup>339</sup> *McKerlie v Drillsearch Energy Ltd* [2009] NSWSC 488 at [24], referring to *Second Consolidated Trust Ltd v Ceylon Amalgamated Tea & Rubber Estates Ltd* [1943] 2 All ER 567. See also *In the matter of Print Mail Logistics Limited* [2012] NSWSC 792 at [5]-[7].

<sup>340</sup> Minter Ellison Alert: *When is the chair obliged to demand a poll at a shareholders' meeting?* Corporate HQ Advisory Newsletter, 9 August 2012.

<sup>341</sup> Under s 250U, votes against the resolution to approve the remuneration report of at least 25% of the votes cast constitute a first or second strike which can lead to a requirement to put a board spill resolution to the shareholders.

<sup>342</sup> Minter Ellison Alert: *When is the chair obliged to demand a poll at a shareholders' meeting?* Corporate HQ Advisory Newsletter, 9 August 2012.

<sup>343</sup> *ibid.* For instance, the power of a chair to adjourn a meeting must be exercised in good faith and for a proper purpose: *McKerlie v Drillsearch Energy Ltd* [2009] NSWSC 488 at [29].

### **General formulation of functions and duties**

The CASAC Report considered whether a more general formulation of the functions and duties of the chair should be set out in legislation or in a best practice code.<sup>344</sup> The report commented that a formulation might be along the following lines:

It is the duty of the chair of a meeting of a company's shareholders to facilitate the business of that meeting and to ensure that an expression of the true will of the shareholders present and represented is obtained on all the matters to be decided by the meeting. The chair should administer the meeting fairly to ensure that the persons present have a reasonable opportunity to debate those matters in a manner calculated to allow the meeting to proceed efficiently. While the chair has a duty to maintain order, it is no part of his or her function to allow procedures and formalities to prejudice the attainment of the meeting's objects. Substance must prevail over form.

The CASAC Report considered that the broad general language of any such formulation of the functions and duties of the chair would make it unsuitable for legislation, or could create considerable difficulties or uncertainties in its interpretation.<sup>345</sup> However, the formulation could be a good corporate governance model that could be adopted in industry best practice guidelines.<sup>346</sup>

### **5.7.3 Ensuring attendance of particular persons**

The UK Corporate Governance Code provides that the chair should arrange for the chair of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.<sup>347</sup>

There is no equivalent requirement for Australian companies.

### **5.7.4 Chair moving motions**

There is some case law to the effect that a chair cannot lawfully move motions and any resolution so passed is invalid, at least where the chair is not a shareholder.<sup>348</sup>

Nevertheless, the CASAC Report did not favour a statutory amendment to dispense with the formalities of moving and seconding motions at company meetings, as:

- this requirement is only a minor administrative procedure that does not create a material procedural obstacle to the conduct of meetings
- it is doubtful, if the question of the chair's right to move motions arose again, that the single adverse judgment would be followed or that a resolution resulting from a motion moved by the chair would, for that reason, be held invalid

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<sup>344</sup> paras 4.151-4.159.

<sup>345</sup> para 4.159, rec 25.

<sup>346</sup> para 4.159.

<sup>347</sup> UK Corporate Governance Code Section E.2.3.

<sup>348</sup> In *Re Vector Capital Ltd* (1997) 15 ACLC 421, 23 ACSR 182, Young J of the New South Wales Supreme Court held that 'it is not appropriate an impartial chairman should move motions; and, secondly, more importantly [the chairman] was not qualified to do so because he was not a shareholder. If a motion is invalidly moved, in my view, it cannot be passed.'

- the court has a discretion under s 1322 to validate any proceeding suffering from procedural irregularity, including the process of passing resolutions at shareholder meetings.<sup>349</sup>

### 5.7.5 Motions of dissent from a chair's rulings

Shareholders may seek to move a motion of dissent from a chair's ruling.

In some circumstances, an attempt to move a motion of dissent is precluded by legislation. For instance, a challenge to the right to vote at an AGM may only be made at the meeting, and must be determined by the chair, whose decision is final.<sup>350</sup> This promotes finality and means that the validity of votes cast at an AGM cannot be later disputed if no challenge was made during the meeting, unless fraud or bad faith is established.<sup>351</sup>

At common law, shareholders cannot overturn a chair's ruling to disallow a motion that is outside the competence of the meeting. On that basis, a chair could also lawfully rule invalid any motion of dissent from that ruling. In consequence, on that reasoning, shareholders could not lawfully pass a motion of dissent from a chair's ruling that:

- a director or other company officer not be required to answer questions put to that person at the AGM<sup>352</sup>
- particular resolutions are invalid as they involve matters of management that the company's constitution lawfully and exclusively vests in the directors,<sup>353</sup> or
- no poll be held on a resolution that the meeting be adjourned (if the company's constitution so provides).<sup>354</sup>

The CASAC Report considered possible ways that legislation could regulate the process of dissenting from a chair's ruling,<sup>355</sup> for instance by:

- expressly stipulating that shareholders may only move motions of dissent on matters about which the meeting may make lawful decisions, or
- providing that any ruling by the chair could only be challenged in court, not at the meeting itself through a motion of dissent (this would avoid a company's meeting being unduly prolonged through such motions).

<sup>349</sup> paras 4.165, 4.168, rec 26. In regard to the application of s 1322 to passing resolutions at shareholder meetings, see *Scullion v Family Planning Assn of Queensland* (1985) 10 ACLR 249; *Talbot v NRMA Holdings Ltd* (1996) 139 ALR 755; *Cordiant Communications (Australia) Pty Ltd v Communications Group Holdings Pty Ltd* [2005] NSWSC 1005 at [87].

<sup>350</sup> s 250G (a replaceable rule). An objection to a right to vote can be made at any time during a meeting: *MTQ Holdings Pty Ltd v RCR Tomlinson Ltd* [2006] WASC 96.

<sup>351</sup> A court may set aside a chair's decision if made in bad faith or through an error of law, but not if made in good faith, albeit mistakenly, and without any error of law: *Link Agricultural Pty Ltd v Shanahan* [1998] VSCA 3, *Fast Scout Ltd v Bergel* [2001] WASC 343 at [67]-[70], *Australian Olives Ltd v Livadaras* [2008] FCA 1407 at [70].

<sup>352</sup> Sections 250S and 250T require the chair to permit shareholders at the AGM to ask questions of company management or the company auditor. However, there is no legal obligation on these persons to answer those questions.

<sup>353</sup> *NRMA v Parker* (1986) 11 ACLR 1, 4 ACLC 609.

<sup>354</sup> Under s 250K(2), a company's constitution may provide that a poll cannot be demanded on any resolution concerning the adjournment of a meeting.

<sup>355</sup> paras 4.169-4.182.

The Report considered that the common law was adequate and that statutory regulation of this matter was unnecessary.<sup>356</sup>

### Questions

What, if any, changes are needed to the current position concerning:

- the general functions and duties of the chair
- the chair ensuring attendance of particular persons at the AGM
- the chair moving motions
- motions of dissent from a chair's rulings?

Should a chair be obliged to provide shareholders with a reasonable opportunity to discuss a resolution before it is put to the vote?

Should a chair have the power to impose any time, or other, limits on an individual shareholder speaking at the AGM?

## 5.8 Proxy voting

### 5.8.1 Role of proxy voting

Shareholders who wish to participate in an AGM without attending the meeting in person have the right to appoint a proxy to attend the meeting and vote on their behalf.<sup>357</sup> The proxy may be either an individual or a body corporate, and may be a proxy for all or some of the shareholder's votes. The appointment of a proxy has been described as a temporary transfer to another party of some of the rights attached to membership in a company.<sup>358</sup>

The ability to cast a proxy vote is seen as an important shareholder right. For instance, the Australian Council of Superannuation Investors (ACSI) *A guide for superannuation trustees to monitor listed Australian companies* (July 2011) states:

Access to the proxy voting process is an important means by which shareholders can ensure that directors are held accountable for their actions and the future direction of the company.

Proxy voting is therefore a key mechanism by which shareholders play a role in the governance of the company. General principles of shareholder rights require companies to encourage shareholder access to the proxy process.<sup>359</sup>

### 5.8.2 Informing shareholders of their right to appoint a proxy

Any notice of an AGM must include a statement informing shareholders of:

- their right to appoint a proxy
- whether or not the proxy needs to be a member of the company

<sup>356</sup> rec 27.

<sup>357</sup> s 249X. This provision is mandatory for all public companies.

<sup>358</sup> CSA/Blake Dawson (now Ashurst Australia) discussion paper *Rethinking the AGM* (2008) at 8 (Section 3.2).

<sup>359</sup> Section 17.1.

- their right, if entitled to cast two or more votes, to appoint two proxies and specify the proportion or number of votes each proxy is appointed to exercise.<sup>360</sup>

If a company decides to send a proxy appointment form or a list of persons willing to act as proxies, it must send the relevant document to all shareholders.<sup>361</sup>

In addition, the ASX Listing Rules require that all listed companies include a proxy form in any notice of meeting.<sup>362</sup> The proxy form must enable the shareholder to decide whether to vote for or against each resolution (and may also provide for the shareholder to abstain from voting on each resolution) or instead give the proxy a discretion to vote for or against each resolution.<sup>363</sup>

### 5.8.3 The proxy form

For a proxy appointment by a shareholder to be valid, the proxy form must be signed or authenticated in a manner prescribed by the regulations (which apply to electronic lodgment<sup>364</sup>) and contain:

- the shareholder's name and address
- the company's name
- the proxy's name or the name of the office held by the proxy
- the meetings at which the appointment may be used.<sup>365</sup>

A company's constitution may provide for the validity of a proxy appointment that contains only some of this information.<sup>366</sup> Conversely, a proxy may be valid if it contains the information specified in the legislation, even if does not meet the requirements under the company's constitution.<sup>367</sup>

There is no statutory requirement that proxy appointment forms be dated. An undated appointment is taken to have been dated on the day it is given to the company.<sup>368</sup>

A later appointment of a proxy revokes an earlier one if both appointments could not be validly exercised at the meeting.<sup>369</sup>

<sup>360</sup> s 249L(1)(d). For the purpose of constituting a quorum, a shareholder will be counted as a single member even if two or more proxies appointed to attend the meeting attend and vote different portions of the person's voting entitlements. This view appears to have been accepted in *Chalet Nominees (1999) Pty Ltd v Murray* [2012] WASC 147.

<sup>361</sup> s 249Z.

<sup>362</sup> ASX Listing Rule 14.2. ASX Listing Rule 14.1 provides:

If a listing rule requires a notice of meeting to include information, that information may be in the notice or accompany it.

<sup>363</sup> ASX Listing Rule 14.2.1, with accompanying note. It has been held, on an application for an interlocutory injunction, that, where a company has sent out a proxy form providing for shareholders to vote for or against a resolution, the purpose of this listing rule is not defeated if the company subsequently sends out a proxy form that is completed for or against the resolution and such an action is also not a breach of the directors' duty of good faith under s 181: *Riverfront Nominees Pty Ltd v Beacon Minerals Ltd* [2012] WASC 154.

<sup>364</sup> Corp Reg 2G.2.01.

<sup>365</sup> s 250A(1).

<sup>366</sup> s 250A(2).

<sup>367</sup> *Bisan Ltd v Cellante* [2002] VSC 430.

<sup>368</sup> s 250A(3).

<sup>369</sup> s 250A(7).

The ASX Listing Rules also require that, where the chair of a meeting is appointed as proxy, either through the failure of a shareholder to appoint a proxy or by default, and the chair would be excluded from voting on a resolution, the proxy form must:

- state how the chair of the meeting intends to vote undirected proxies
- contain a statement:
  - inviting the shareholder to mark a box to acknowledge that the chair may exercise the shareholder’s proxy even if the chair has an interest in the outcome of the resolution/s and that votes cast by the chair other than as proxy holder will be disregarded because of that interest
  - informing the shareholder that failure to mark the box or direct the proxy how to vote will result in the votes not being counted on the resolution.<sup>370</sup>

Chartered Secretaries Australia (CSA) has provided a best practice proxy form for companies. At ASIC’s request, CSA is updating this proxy form in light of new legislative requirements.

#### 5.8.4 Pre-completed proxies

It has been held that s 250A permits a person to send proxy forms to shareholders with the name of the proxy and the voting boxes already completed.<sup>371</sup>

Questions have been raised whether this practice is consistent with good corporate governance. Also, permitting pre-completed proxies may seem out of step with ASX Listing Rule 14.2, which requires that proxy forms sent with notices convening any meeting of shareholders shall enable shareholders to vote for or against each resolution, rather than leaving the decision to the proxy.<sup>372</sup>

#### 5.8.5 Notifying the company of the proxy appointment

For the appointment of a proxy for an AGM to be effective, the company must receive various documents no later than 48 hours prior to that meeting unless that period is reduced by the company’s constitution or the notice of meeting.<sup>373</sup> The requirement for prior lodgement of proxies is intended to allow an investigation of their validity prior to the commencement of the meeting.<sup>374</sup> Appointments notified after the cut-off time are invalid.<sup>375</sup>

Shareholders may lodge proxy documents in various ways, including electronically if provided for by the company.<sup>376</sup> ASIC has indicated that a listed company can accept proxy votes for general meetings lodged by electronic means without its constitution being amended to permit that course.<sup>377</sup> Electronic lodgement can provide prompt confirmation of

<sup>370</sup> ASX Listing Rules 14.2.3A, 14.2.3B.

<sup>371</sup> *Fast Scout Ltd v Bergel* [2001] WASC 343.

<sup>372</sup> HAJ Ford, RP Austin & IM Ramsay, *Ford’s Principles of Corporations Law* (loose leaf, LexisNexis Butterworths) at [7.560].

<sup>373</sup> s 250B.

<sup>374</sup> *New South Wales Henry George Foundation Ltd v Booth* [2002] NSWSC 245 at [19].

<sup>375</sup> *Armstrong v Landmark Corp Ltd* [1967] 1 NSW 13.

<sup>376</sup> s 250BA. Corp Reg 2G.2.01 deals with authentication of appointment of a proxy by electronic means.

<sup>377</sup> ASIC IR 10-85AD *ASIC confirms proxy documents can be lodged electronically* (April 2010). This advisory was issued in response to Recommendation 14 in the Productivity Commission’s report *Executive Remuneration in Australia* (December 2009).

receipt of proxy documents and an electronic means of checking the shareholder's voting entitlement.

There are conflicting judicial views on whether the return of a proxy appointment to the company indirectly by a third person, rather than by the shareholder giving the proxy, invalidates that appointment. The issue turns on whether having a third party forwarding proxy documents to the company could raise doubt about the integrity of the election process.

One line of authority is that, if proxy forms solicited by third parties are sent to the proxy for some other party for lodgment with the company, they will not comply with the provision dealing with the company's receipt of proxy documents.<sup>378</sup> This requirement was implied into the provisions on the basis that proxies should be received by persons subject to fiduciary duties, which will safeguard the actual and apparent integrity of the corporate voting process.<sup>379</sup>

However, as observed in one commentary:

the court's reasoning that a proxy is otherwise under no fiduciary duties to the appointor sits somewhat uneasily with the decision of the NSW Court of Appeal in *Whitlam v ASIC*.<sup>380</sup>

In *Whitlam v ASIC*,<sup>381</sup> the court held that a director who accepts an appointment as a shareholder's proxy for the purposes of the general meeting incurs the fiduciary duties of an agent towards the appointing shareholder.

Some more recent cases have cast doubt on the breadth of the restriction, particularly where proxies were provided to an independent third party who could be trusted to administer them fairly (such as a share registry) for lodgment with the company.<sup>382</sup>

One policy option is for the legislation to stipulate that proxies must be sent directly by any shareholder appointing a proxy either to the company or to any other entity or entities nominated by the company.<sup>383</sup>

A proxy appointment remains valid even if the shareholder dies, becomes mentally incapacitated, revokes the appointment or transfers the relevant shares, unless the company receives written notice of the matter before the start of the meeting at which the proxy votes.<sup>384</sup>

<sup>378</sup> s 250B.

<sup>379</sup> *Bisan Ltd v Cellant* [[2002] VSC 430. See also *Portman Iron Ore Ltd; Re Golden West Resources Ltd* [2008] FCA 1362. Compare *Lion Selection Limited 02* [2008] ATP 16 at [33], where the Takeovers Panel expressed the view that unacceptable circumstances might arise where an intermediate party filters or otherwise inappropriately handles proxies.

<sup>380</sup> E Boros and J Duns, *Corporate Law* (2nd edn, Oxford University Press, 2010) at 130.

<sup>381</sup> [2003] NSWCA 183 at [152].

<sup>382</sup> *City Pacific Ltd v Bacon* [2009] FCA 687, *Lachlan Reit Ltd v Garnaut* [2010] VSC 399 and *Carpathian Resources Limited v Highmoor Business Corporation* [2010] FCA 1294, *Carson v Dynasty Metals Australia Limited* [2011] FCA 621, *Northwest Capital Management v Westate Capital Ltd* [2012] WASC 121 at [110]-[118].

<sup>383</sup> Larger listed public companies may use specialist registry managers to maintain their share registry, check and collate the voting.

<sup>384</sup> s 250C(2).

### 5.8.5A Audit trail for lodged proxy votes

[The ACSI Research Paper \*Institutional Proxy Voting in Australia\* \(October 2012\) pointed out that presently no issuer or its registry provides shareholders with authoritative acknowledgement that their proxy votes have been received and processed:](#)

[This creates an imperfect audit trail, which makes the accurate publication of voting instructions for institutional investors challenging.<sup>385</sup>](#)

[The paper argued that the need for an effective audit trail is even more pressing in light of \*Campbell v Jervois Mining Ltd\* \[2009\] FCA 401 where the Federal Court held, in effect, that the chair's statement of intention in the notice of meeting as to how undirected proxies would be voted was not binding on the chair and the chair could thus validly vote such proxies in a manner contrary to the previously declared intention. The paper recommended that companies be obliged to acknowledge, in electronic form only, that the votes of shareholders have been processed \(or discarded\) and to confirm what proportion of the final results their votes represented.<sup>386</sup>](#)

### 5.8.6 Record date and proxy appointment date

A person may only vote if recorded on the register of members as a holder of shares at the 'record date'. This term, while not defined in the Corporations Act, refers to the date on which the company regards a person as having legal ownership of the shares, for the purpose of determining voting entitlement. For listed entities, the record date must not be more than 48 hours before the meeting.<sup>387</sup> This time has been set as close to the meeting as possible to ensure an accurate record of the shareholder group for the meeting.

Forms appointing a person as a proxy must be received by the company at least 48 hours before a meeting.<sup>388</sup> This deadline is to provide the company with sufficient time to process the proxy votes prior to the meeting.

In practice, the record date and proxy appointment cut-off date usually coincide. This coincidence can affect voting entitlements, with the possibility of some votes being 'lost' or miscounted. As described by the Productivity Commission, the same cut-off dates:

can result in shareholders submitting their proxy prior to their voting entitlements being determined, leading to a discrepancy between voting entitlements and the number of votes cast. If the number of proxy votes submitted exceeds the number of votes a shareholder is entitled to, this can result in all votes from the shareholder being rejected. In addition, the dates may result in many votes being submitted at the last minute, leaving little time to resolve any queries.<sup>389</sup>

One possibility to overcome this problem is to extend the record date to, say, 5 business days before the meeting. While recognising the benefits of this approach, the Productivity Commission also expressed concerns with some consequences for persons who sold or purchased shares after the record date:

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<sup>385</sup> [Section 10.5](#)

<sup>386</sup> [Section 10.5 and Recommendation 5. A similar approach has been proposed by D Paatsch and S Connal in 'The dark side of proxy voting' \*Business Spectator\* 1 November 2012.](#)

<sup>387</sup> Corp Reg 7.11.37.

<sup>388</sup> s 250B.

<sup>389</sup> Productivity Commission Report *Executive remuneration in Australia* (December 2009) at 312. See also AMP Capital Investors: Lost votes: finding a way forward *Corporate Governance Report* March 2009, which made similar observations.

Extending the record cut-off date would provide an increased buffer between the establishment of voting entitlements and submitting votes. This would decrease the risk that shareholders (especially institutional investors) lodge more votes than they are entitled to. Further, as it would allow institutions to vote earlier, there may be more time to resolve any potential discrepancies.

There are some disadvantages associated with extending the record cut-off date. Such a change would increase the risk that votes may be cast by shareholders who no longer have a substantive interest in the company. That is, shareholders may sell their shares before the meeting (but after the record cut-off date). Similarly, shareholders may buy shares after the record cut-off date and therefore not be able to vote at the meeting. These issues are amplified the further out from the meeting the record cut-off date is set.<sup>390</sup>

The Productivity Commission supported greater use of electronic means of lodging proxy appointments, or voting directly by electronic means before the meeting (see further Section 5.9) as one means to overcome some of the problems of ‘lost’ or miscounted votes:

It should be noted that the need for a record cut-off date is reduced with the introduction of electronic voting. The US state of Delaware (where most US companies are registered) has recently changed its regulations to move the cut-off date closer to the general meeting. The new regulations allow for the board to set a record cut-off date, differing from the date the notice of meeting is sent. There is no limit on how late this date can be set — potentially it could be set on the day of the meeting.

Consequently, encouraging electronic voting may be a better option as it would also reduce the risk of a discrepancy between voting entitlements as determined at the record cut-off date compared to entitlements at the time of the meeting. In the absence of the widespread take-up of electronic voting, extending the record cut-off date becomes more important as a means of reducing lost votes.<sup>391</sup>

The PJC<sup>392</sup> and an AICD Paper<sup>393</sup> have each noted the advantages of electronic proxy voting, or even electronic direct voting, over paper-based proxy voting. The view was expressed that electronic voting would assist in establishing a clearer audit trail than paper-based voting and may enable the maximum cut-off time for lodging proxy appointments to be shortened. Currently, where some votes are lodged by post or by fax, it may be impossible for institutional share owners to see the entire voting chain and to be certain that their votes have been voted as instructed.<sup>394</sup>

[The ACSI Research Paper \*Institutional Proxy Voting in Australia\* \(October 2012\) commented that the coincidence of the record date and the proxy appointment cut-off date:](#)

[creates the potential for discrepancies between the votes lodged via proxies and the vote entitlement regarded as authoritative by the company. Many of the weaknesses in the current proxy voting system would be relieved by separating the coincidence of these dates.](#)<sup>395</sup>

[The paper recommended the record date be changed to five business days before a meeting, with the deadline for proxy lodgements being retained at two calendar days before a](#)

<sup>390</sup> Productivity Commission at 312-313.

<sup>391</sup> id at 313.

<sup>392</sup> *Better shareholders – Better company* (2008) at 46.

<sup>393</sup> AICD paper *Institutional share voting and engagement* (September 2011) Finding 9.

<sup>394</sup> AICD paper *Institutional share voting and engagement* (September 2011) Finding 9.

<sup>395</sup> [Section 10.1.](#)

[meeting.<sup>396</sup> The paper argued that the earlier record date, to determine voting entitlements, would provide sufficient time for the reconciliation of proxy votes lodged.<sup>397</sup>](#)

### 5.8.7 Irrevocable proxies

Some overseas jurisdictions recognise irrevocable proxies, whereby the proxy holder retains proxy powers during such time as that holder has a specific interest in the shares. This form of proxy enables creditors of shareholders to protect their interests by having the irrevocable right to vote the relevant shares while their debt remains outstanding.

The Australian legislation recognises standing proxies,<sup>398</sup> but makes no provision for irrevocable proxies. In fact, some provisions seem to be inconsistent with the notion of an irrevocable proxy.<sup>399</sup>

The CASAC Report did not support specific legislative recognition of irrevocable proxies, on the basis that:

- the existing law is based on the premise that companies treat all proxies as revocable
- parties may by private arrangement place conditions or restrictions on the use of that proxy power
- companies should not become involved in that private contractual arrangement by being required to recognise irrevocable proxies.<sup>400</sup>

### 5.8.8 Directed and undirected proxies

Proxy votes can be directed or undirected.

#### *Directed proxies*

Directed proxies are where the shareholder instructs the proxy how to exercise all or some of the votes attached to the shareholder's shares on a particular resolution.

On one view, directed proxies may be unnecessary, or become less frequently used as a method of voting, where a company permits direct voting before the meeting (see Section 5.9), which allows a shareholder to vote prior to, and without having to attend, the meeting or appoint a proxy.

#### *Undirected proxies*

Undirected proxies are where the shareholder gives the proxy a discretion whether to cast the shareholder's votes on a particular resolution and, if so, how.

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<sup>396</sup> Recommendation 1: Amend Corporations Regulations Reg 7.11.37 (3). Replace 'not more than 48 hours' with 'five (5) business days'. A similar approach has been proposed by D Paatsch and S Connal in 'The dark side of proxy voting' *Business Spectator* 1 November 2012.

<sup>397</sup> Section 10.1.

<sup>398</sup> s 250A(1).

<sup>399</sup> ss 249Y(3) (a proxy's right to speak and vote at a meeting is suspended while the shareholder is present at the meeting, unless the company's constitution provides to the contrary), 250A(7) (a later proxy appointment automatically revokes an earlier proxy appointment if both appointments could not be validly exercised at the meeting).

<sup>400</sup> para 4.30, rec 11.

An undirected proxy given to the chair of the meeting or another member of the incumbent board can be regarded as a demonstration of the shareholder's support for that board.

There are specific provisions dealing with undirected proxies given to the chair or other key management personnel on remuneration-related resolutions.<sup>401</sup>

### 5.8.9 Renting shares

Somewhat analogous to providing undirected proxies is the practice of shareholders 'renting' some or all of their shares to another party, thereby giving that other party the power to cast the votes attached to those shares at the AGM.

A survey in 2012 by Allens Linklaters of its listed clients<sup>402</sup> indicated support from respondents for the proposition that the practice of renting shares be regulated or restricted, with the view being expressed that:

the 'lessee' can use the AGM forum for their own interests rather than the general interests of the shareholding body.<sup>403</sup>

### 5.8.10 Proxy speaking and voting at the AGM

In general, a proxy has the same rights as a shareholder to speak and vote at a meeting.<sup>404</sup> Also, a court may review a chair's decision to disallow a proxy.<sup>405</sup>

A proxy who holds directed proxies is permitted to vote those proxies, even where the proxy is excluded from voting in that person's own right.<sup>406</sup>

The issue of 'cherry picking' (where proxy holders choose to exercise proxies that support their position and disregard those that do not) has been addressed by statutory amendments in 2011, designed to ensure that all proxies are voted as intended.<sup>407</sup> Under these provisions:

- a proxy who is the chair of the meeting must vote on a poll, and must vote as directed
- a proxy who is not the chair need not vote but, if he or she does vote, must vote as directed
- if a nominated proxy does not register as attending the meeting or attends but does not vote, the proxies not exercised in a poll vote will default to the chair, who has a duty to vote the proxies as directed.<sup>408</sup>

<sup>401</sup> s 250BD. Also, s 250R(5) (as amended in June 2012 by the *Corporations Amendment (Proxy Voting) Act 2012*) deals with the voting by a chair of undirected proxies in relation to resolutions on the remuneration report of listed companies. The chair is permitted to vote undirected proxies that have been vested in that person, provided there is express authorisation by the shareholder. See further CSA *Guidelines on managing voting exclusions on remunerated-related resolutions* (2012).

<sup>402</sup> The respondents comprised board chairs, non-executive directors, chief executive officers/chief financial officers, General and Legal Counsel and Company Secretaries of various large, mid and small cap listed companies.

<sup>403</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 11.

<sup>404</sup> s 249Y. Unless a company's constitution specifies otherwise, the proxy's authority to speak and vote at a meeting is suspended while the proxy's appointor is present at the meeting.

<sup>405</sup> *ANZ Nominees Ltd v Allied Resources Corp Ltd* (1984) 2 ACLC 783, *Fast Scout Ltd v Bergel* [2001] WASC 343 at [67]-[68].

<sup>406</sup> s 250C(1). See for instance ss 250R(5) (voting on the remuneration report), 250V(2) (voting on a board spill resolution if the two-strikes rule is activated), 224(2) (related party transactions).

<sup>407</sup> Explanatory Memorandum to the Corporations Amendment (Improving Accountability on Director and Executive Remuneration) Bill 2011, para 6.10.

<sup>408</sup> ss 250BB and 250BC.

Also, the chair of an AGM who is also a member of the key management personnel of the company can vote undirected proxies held by that person in a non-binding shareholder vote on remuneration where the shareholder provides express authorisation.<sup>409</sup>

## Questions

What changes, if any, should be made to the current requirements concerning:

- informing shareholders of their right to appoint a proxy
- the proxy form
- pre-completed proxies
- notifying the company of the proxy appointment
- [providing an audit trail for lodged proxy votes](#)
- the record date and the proxy appointment date
- irrevocable proxies
- directed and undirected proxies
- renting shares
- proxy speaking and voting at the AGM, or
- any other aspect of proxy voting.

## 5.9 Direct voting before the meeting

### 5.9.1 Nature of this vote

Direct voting before the meeting involves the shareholder casting a vote on one or more matters and forwarding that vote or votes to the company by post, fax or electronically prior to a cut-off time before the AGM, rather than voting in person or by proxy at the meeting.

The CASAC Report, in supporting any form of voting that would assist shareholder participation in corporate decision making, considered that direct voting before the meeting should be permitted to the extent allowed by a company's constitution.<sup>410</sup>

Since that report, greater use has been made of this form of voting, which is seen as available for shareholders of companies that both permit it in their constitutions and offer it. This increased usage may have been assisted by guidance provided on implementation issues<sup>411</sup> and support from interest groups.<sup>412</sup> A survey of AGMs conducted in 2011 indicated that eleven companies in the ASX top 50 companies permitted shareholders to cast direct votes before the meeting as an alternative to appointing a proxy or attending the AGM in person. A further two companies in the ASX top 50 adopted amendments to their constitutions which would permit direct voting before the meeting at future shareholder meetings.<sup>413</sup>

<sup>409</sup> s 250R(5).

<sup>410</sup> paras 4.118-4.143.

<sup>411</sup> *CSA's guide to implementing direct voting* (2007); R McMullan, Partner, Johnson Winter & Slattery *Online voting by shareholders without a proxy form* (May 2010).

<sup>412</sup> See, for instance, Australian Shareholders' Association Policy Statement *Direct Voting* (December 2008).

<sup>413</sup> Johnson Winter & Slattery, *2011 AGM season survey results*, February 2012.

## 5.9.2 Implementation issues

### *Regulatory backing*

Though increasingly used in practice, this form of voting is not referred to in the Corporations Act or the ASX Listing Rules.

On one view, companies may be more inclined to utilise direct voting before the meeting if it is specifically provided for in the legislation or Listing Rules. According to one commentary:

Placing direct voting on a firmer regulatory footing may further encourage its use and development, although care would need to be taken to avoid a too prescriptive approach.<sup>414</sup>

Companies may be concerned that without some form of regulatory backing, the validity of votes cast by direct voting before the meeting may be subject to challenge.

Where employed, this form of voting could be completed:

- by a form sent to the company by post, or
- electronically by a form sent to the company by fax, or
- electronically through the Internet.

The time limit for lodging direct votes before the meeting could be the same as the proxy appointment date (48 hours before the meeting) or even closer to the meeting if lodged electronically (and therefore with the capacity to be automatically checked electronically).

### *Change of voting intention*

An issue that arises with the various ways of casting a direct vote before the meeting is whether a party should be permitted to change that vote, once lodged, and, if so, what mechanism might best ensure that there is no confusion about that party's voting intention.

The CASAC Report considered the situation where a shareholder forwards a direct vote by mail and subsequently lodges a contrary electronic direct vote.<sup>415</sup> The report took the view that the first direct vote received and recorded by the person collating these votes on behalf of the company should be the valid vote, with any later received contrary direct vote to be disregarded.

The Report recognised that this approach would differ from proxies, where a shareholder may change the proxy and a later appointment will revoke an earlier appointment if both could not be validly exercised at the meeting.<sup>416</sup> However, the CASAC Report saw its approach as a pragmatic solution, to overcome the difficulty of companies otherwise having to deal with changes to direct votes cast before the meeting, which could unduly complicate this voting system and discourage its use by companies.

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<sup>414</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 8.

<sup>415</sup> paras 4.134-4.135, rec 20.

<sup>416</sup> s 250A(7).

### **Amendments to resolutions**

Another issue concerns how to deal with direct votes cast before the meeting when amendments to a resolution are put forward at an AGM. Under current law, a person appointed as a proxy can vote on an amendment either if the terms of the proxy expressly or by necessary implication cover that amendment or if the amendment is consistent with the substance of the original proxy direction. The CASAC Report considered that the chair should apply the same principles to direct votes cast before the meeting.<sup>417</sup>

#### **Question**

Should direct voting before the meeting be provided for by legislative or other means, and if so what matters should be covered in any regulatory structure?

## **5.10 Disclosure of pre-meeting voting**

### **5.10.1 Access to information on pre-meeting votes before the AGM**

Pre-meeting votes comprise proxy votes (Section 5.8) and direct votes lodged before the meeting (Section 5.9).

Companies may, but usually do not, publicly disclose information (once-off or progressively) on pre-meeting votes. However, as part of their general common law right of access to company records for management purposes, directors are entitled to inspect lodged proxies to ensure their effectiveness, provided that they act in good faith.<sup>418</sup> There is no statutory prohibition on directors employing this inspection right to monitor the trend of proxy or any direct voting leading up to the AGM.

Shareholders have no equivalent right of access to pre-meeting votes prior to the meeting. In limited circumstances, individual shareholders may seek a court order to obtain access where they are acting in good faith and the inspection is sought for a proper purpose, such as for the purpose of litigation.<sup>419</sup> The court may limit the use that a shareholder may make of the information obtained.<sup>420</sup>

Companies may disclose pre-meeting voting trends to particular external parties, such as the proponents of particular resolutions. In some circumstances, any such disclosure before the AGM may constitute material information that must be publicly disclosed under the continuous disclosure requirements (for instance, where the pre-meeting voting indicates a clear outcome on a resolution that will have a material effect on the price or value of the company's securities, depending upon the outcome of the vote).

The question is whether, in other circumstances, this knowledge of pre-meeting voting could give the company directors or other informed persons an unjustified advantage in some manner, particularly if the resolution is contentious. For instance, directors could use this

<sup>417</sup> para 4.136.

<sup>418</sup> A director has a common law right to inspect proxy instruments that have been lodged, as they may be relevant to whether the individual rights of shareholders are being properly observed: *Armstrong v Landmark Corporation Ltd* [1967] 1 NSW 13. See also *Lew v Coles Myer Ltd* [2002] VSC 535.

<sup>419</sup> s 247A.

<sup>420</sup> s 247B.

information to solicit votes<sup>421</sup> or otherwise try to influence the outcome of shareholder resolutions by, say, choosing to publish a progressive tally of pre-meeting votes where they consider that this will assist their position.

The CASAC Report considered whether the legislation should restrict or expand access to pre-meeting votes.<sup>422</sup> The report favoured a person independent of the directors, such as the auditor, receiving and collating pre-meeting votes. This would avoid the possibility, or perception, of directors carefully reviewing the validity only of those proxies that oppose their position. The report considered that this approach should be adopted as a matter of good corporate governance, possibly backed by exchange listing rules, rather than by statutory requirement.<sup>423</sup>

The CASAC Report also noted that undesirable consequences may follow from giving shareholders general inspection rights in relation to lodged proxies prior to the meeting:

it could also increase administrative costs and permit shareholders to ascertain how individuals, prior to the meeting, have directed their proxies to vote, thereby raising privacy issues, given that some shareholders consider that voting on company issues should be by secret ballot. It may result in many shareholders not putting in their proxies until the last moment. These problems might be reduced if directors and shareholders were limited to a summary of proxy voting, rather than having access to the original lodged proxies, though some observers could still deduce from the timing or size of any summary disclosure how particular large shareholders had instructed their proxy to vote.<sup>424</sup>

### Question

In what circumstances, if any, should access to pre-meeting voting information be permitted?

#### 5.10.2 Disclosure of pre-meeting votes before discussion on a resolution

Subject to any pre-meeting disclosure, or relevant direction in the company's constitution, it is a matter of discretion for the chair whether information on pre-meeting voting on a proposed resolution is disclosed before, or when commencing, discussion on the resolution at an AGM.

The question is whether there should be any regulation of this matter, given that the timing of any disclosure can have significant implications for the course of that discussion. As summed up in one commentary:

Advocates for revealing the proxies early, before the discussion and any voting, argue that it provides a realistic assessment of the voting intentions of the majority ... The counter view is that early advice on [pre-meeting votes] received stifles discussion and debate at the AGM. Some shareholders may feel disenfranchised by the institutional shareholders who have [already] voted.<sup>425</sup>

<sup>421</sup> For instance, directors could approach particular shareholders who have already submitted their proxies to persuade them to change their voting directions. They could also approach particular remaining shareholders to persuade them to lodge favourable proxies or cast direct votes before the meeting.

<sup>422</sup> paras 4.44-4.57.

<sup>423</sup> para 4.56, rec 14 and para 4.138, rec 21.

<sup>424</sup> para 4.50.

<sup>425</sup> J Stafford, *Engaging with shareholders* (AICD) 2011 at 79.

In its consideration of this matter, the CASAC Report outlined the following options for the disclosure of pre-meeting voting information:

- prohibit its disclosure before discussion of the proposed resolution
- require its disclosure before, or at the commencement of, that discussion
- leave it to shareholders to determine whether this information is disclosed in advance, or at the beginning, of that discussion, or
- continue to leave this matter to the discretion of the chair.<sup>426</sup>

The CASAC Report concluded that:

- it would be undesirable to attempt to prescribe by legislation whether pre-meeting voting figures should be disclosed in advance of any discussion on a particular resolution. In some instances, disclosure could be desirable to assist in working through the meeting agenda; in other instances, it might unduly prejudice the opportunity for discussion
- it would be preferable to continue to leave it to the discretion of the chair whether to disclose the pre-meeting voting details prior to considering a particular resolution.<sup>427</sup>

The Business Council of Australia Discussion Paper *Company + Shareholder Dialogue: Fresh approaches to communication between companies and their shareholders* (2004) observed that failing to disclose the pre-meeting voting at the outset of the discussion runs the risk of misleading the meeting if those in attendance believe they have a significant opportunity to influence the final outcome. On the other hand, revealing the results of pre-meeting votes in advance of discussion on a resolution may present the outcome of each of these resolutions as a fait accompli and may stifle any discussion or debate from the floor of the meeting.<sup>428</sup>

A CSA ‘best practice’ guide recommends against the chair disclosing pre-meeting voting information before the discussion at the AGM:

Shareholders can feel intimidated by or resentful of being advised of the [pre-meeting] votes before discussion. It may stifle discussion where the outcome of the vote is beyond question from the [pre-meeting] votes received.<sup>429</sup>

## Question

In what manner if any, should access to pre-meeting voting information be regulated before discussion on a proposed resolution?

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<sup>426</sup> paras 4.58-4.69.

<sup>427</sup> para 4.69, rec 15 and para 4.140, rec 22.

<sup>428</sup> BCA Paper at 37.

<sup>429</sup> CSA *Guide to procedures at AGMs* at 7.

### 5.10.3 Disclosure of pre-meeting votes after discussion but before voting on a resolution

Before a vote is taken on a resolution, the chair must inform the meeting whether any proxy votes have been received and how the proxy votes are to be cast (replaceable rule).<sup>430</sup> However, a company's constitution can make other provision for when this disclosure is to take place prior to completion of the AGM.

It is unclear whether this statutory provision applies only to a vote by show of hands or also to a vote by poll.<sup>431</sup> However, for any vote on a resolution by show of hands, neither the chair nor the minutes need to state the number or proportion of the votes recorded in favour or against.<sup>432</sup>

The legislation does not refer to direct votes cast before the meeting.

The argument for disclosure of pre-meeting voting before the vote is taken at the AGM is that shareholders would be better informed before they cast their votes. The argument against disclosure prior to the vote is that shareholders may be discouraged from voting if the outcome is already determined on the basis of pre-meeting votes.

As commented in one 'best practice' guide:

Some shareholders may view disclosure of the [pre-meeting] votes at this point as intimidatory, but others may view it as essential information that needs to be known before voting takes place.<sup>433</sup>

#### Question

In what manner, if any, should the current requirements concerning the disclosure of pre-meeting votes before voting on a resolution be amended?

## 5.11 Online voting during the AGM

Advances in technology may enable companies to offer shareholders who are absent from the AGM the capacity to cast votes electronically during the course of the meeting, simultaneously with voting by shareholders attending in person. Online votes would be recorded in the same manner, and at the same time, as votes by persons present at the meeting.

On one view, it would suffice for companies to provide for online voting in their constitutions, without the need for legislative amendment.<sup>434</sup> However, companies may be reluctant to embark on this form of voting without the comfort of specific legislative support, to avoid the possibility of challenges being raised to the validity of voting results on the basis of this form of voting.

<sup>430</sup> s 250J(1A).

<sup>431</sup> The lack of clarity arises from the fact that the requirement to provide information on proxy votes is a subsection of s 250J, which deals with voting by show of hands.

<sup>432</sup> s 250J(2).

<sup>433</sup> CSA *Guide to procedures at AGMs* at 7.

<sup>434</sup> Minter Ellison, *Online participation in shareholder meetings – how could it work?* Corporate HQ Advisory Newsletter, September 2011.

Online voting also entails the inherent risk of the technology being utilised by the shareholder failing during the relevant time for voting at the AGM.

One possible approach is to make clear in any legislative or other initiative concerning online voting that the technology risk rests with the shareholder seeking to vote in this way. Inability to vote online during the course of an AGM through technological failure could be seen as analogous to the failure of a shareholder to attend and vote at a physical meeting through some external factor beyond their control, such as a transportation breakdown.

### Question

Should there be legislative or other recognition of online voting during the course of an AGM and, if so, in what respects should this form of voting be regulated?

## 5.12 Exclusions from voting

Various parties may be excluded from voting on particular resolutions that must, or could, be considered at an AGM.

For instance, the directors' report for a financial year of a listed company must include a remuneration report for the company's 'key management personnel',<sup>435</sup> to be set out in a separate and clearly identified section.<sup>436</sup> At the company's AGM, a resolution that the remuneration report be adopted must be put to the vote of shareholders.<sup>437</sup> No vote may be cast on any such resolution by, or on behalf of, any member of the key management personnel, or a closely related party of such a member, where the remuneration details of that member are included in the remuneration report.<sup>438</sup> A similar prohibition applies to voting on a board spill resolution if the two-strikes rule is activated.<sup>439</sup> CSA has published guidelines on these matters, including steps companies can take to manage voting exclusions.<sup>440</sup>

Voting exclusions may apply to other resolutions that companies may choose to include for consideration at an AGM, rather than at a separate shareholders' meeting. For instance, with some exceptions, a public company (or an entity controlled by the public company) may only give a financial benefit to a related party of that company if that transaction is approved by shareholders.<sup>441</sup> In voting on any such approval resolution, no vote may be cast by or on behalf of the related party or an associate of that party (with some exceptions, including where the related party or associate is the holder of directed proxies).<sup>442</sup>

The ASX Listing Rules also place various restrictions on voting on shareholder resolutions, which include resolutions that may be considered at an AGM.<sup>443</sup>

[The ACSI Research Paper \*Institutional Proxy Voting in Australia\* \(October 2012\) pointed out that ASX Listing Rule 7.1 sets out a basic requirement that without prior approval by](#)

<sup>435</sup> s 300A(1), (1A).

<sup>436</sup> s 300A(1).

<sup>437</sup> s 250R(2).

<sup>438</sup> s 250R(4).

<sup>439</sup> s 250V(2).

<sup>440</sup> *Guidelines on managing voting exclusions on remunerated-related resolutions* (2012).

<sup>441</sup> s 208.

<sup>442</sup> s 224. See further ASIC Regulatory Guide 76 *Related party transactions*.

<sup>443</sup> A useful outline of relevant ASX Listing Rules is set out in the CSA paper *Guidelines on managing voting exclusions on remunerated-related resolutions* (2012) at 5.

shareholders, an entity cannot issue (or agree to issue) equity securities representing more than 15% of its equity capital base. Listing Rules 14.11 and 14.11.1 require that shareholders that have subscribed, or may subscribe, to new issues of capital must be excluded from voting on a resolution approving or ratifying the issue of more than 15%. The onus falls on the company to disregard proxy votes once they have been received from the registered holder, typically the sub-custodian, if the sub-custodian had participated in a placement for any of its beneficial holders. However the ASX routinely grants a waiver that exempts custodian nominees from the exclusionary effect of Listing Rule 14.11 provided that ‘the beneficial owner confirms to the nominee that it did not and will not participate in the share issue’.<sup>444</sup>

The ACSI commissioned study did not observe a high incidence of cases where waivers to Listing Rule 14.11 had been requested or granted, but did observe a wide variation in the practice of applying vote exclusions on capital raising resolutions. However, in order to introduce some consistency to the practice of applying vote exclusions to proxy cards lodged by sub-custodians, the ACSI paper recommended that the Listing Rules be adjusted to apply the terms of the waiver that is routinely granted upon the request of an issuer.<sup>445</sup>

The ACSI paper also observed that regardless of the merits of the vote exclusion undertaken, there is limited visibility to investors when votes have been excluded after a sub-custodian has submitted its proxy. It pointed out that s 251AA, which requires the disclosure of proxy information, does not require vote exclusions to be disclosed to market or to the registered holder whose votes have been excluded.<sup>446</sup>It recommended that the provision be amended so that companies be required to report to the market the total number of proxy votes exercisable by all proxies validly appointed but excluded.<sup>447</sup>

### Question

Do any issues arise concerning voting exclusions on resolutions that must, or may, be considered at an AGM and, if so, how might those issues best be resolved?

## 5.13 Voting by show of hands

### 5.13.1 Current position

A show of hands has long been recognised as a method of voting at AGMs and other shareholder meetings. It has been seen as an informal method of determining non-contentious matters expeditiously and inexpensively. However, being one vote per person, it may not represent the true voting position of a company’s shareholders, given that it ignores the number of shares held by each voting shareholder or proxy.

Currently, any resolution put to the vote at a meeting of the shareholders of a company must be decided by a show of hands, unless a poll is demanded (replaceable rule).<sup>448</sup> A company may by its constitution prohibit voting by show of hands on all or some resolutions and require that voting be by poll.

<sup>444</sup> Section 5.3.

<sup>445</sup> Section 10.2 and Recommendation 2.

<sup>446</sup> Section 9.6.

<sup>447</sup> Section 10.3 and Recommendation 3.

<sup>448</sup> s 250J(1).

Each person has one vote on a show of hands, regardless of the size of that person's shareholding (replaceable rule).<sup>449</sup> Proxies can vote on a show of hands, unless forbidden to do so by a company's constitution,<sup>450</sup> or if the proxy has two or more appointments that would require the proxy to vote different ways on the resolution.<sup>451</sup> The chair has a casting vote (replaceable rule).<sup>452</sup>

### 5.13.2 Demanding a poll

A poll may be demanded on most resolutions by the chair, by at least five shareholders or their proxies entitled to vote on those resolutions or by any shareholder with at least 5% of the voting shares.<sup>453</sup> At common law, a chair who holds sufficient proxies contrary to the decision on the show of hands is obliged to demand a poll.<sup>454</sup> In consequence of this requirement and the obligation of a chair to vote all proxies on a poll, the current rules on voting by show of hands do not disenfranchise persons who have lodged their proxies with the chair.

### 5.13.3 Changing approach

In recent years, some companies have appeared to change their attitude to voting by show of hands. For instance, an empirical study conducted in 2000 indicated that most resolutions at that time were still decided by show of hands, without calling for a poll.<sup>455</sup> By contrast, a survey of voting at AGMs in 2011 found that 29 companies in the ASX Top 50 conducted voting at their AGM exclusively by poll. One listed company indicated in its notice of meeting that voting on all matters would occur by way of poll in order to bring to account the large number of proxy votes that it traditionally receives from shareholders.<sup>456</sup>

At least one industry body has expressed concern about voting by show of hands. ACSI has described the passing of resolutions by this method of voting as:

a fundamentally undemocratic and problematic mechanism. ACSI's expectation is for companies to call a poll to provide transparency on the outcome of all resolutions, but especially where a vote is closely contested.<sup>457</sup>

The development of electronic voting devices can also lead to votes on a poll being taken quickly and accurately, and with a full electronic audit trail of votes cast.<sup>458</sup>

[The ACSI Research Paper \*Institutional Proxy Voting in Australia \(October 2012\)\* observed that it was still very common in S&P/ASX300 companies for resolutions to be passed on a](#)

<sup>449</sup> s 250E(1)(a), ASX Listing Rule 6.8.

<sup>450</sup> s 249Y(2).

<sup>451</sup> s 250BB(1)(b).

<sup>452</sup> s 250E(3).

<sup>453</sup> ss 250K, 250L. See also s 249Y(1)(c). However, s 250K(2) provides that a company may provide in its constitution that a poll cannot be demanded on any resolution concerning the election of a chair of a meeting or the adjournment of a meeting. Also, a company's constitution may permit fewer than 5 shareholders or shareholders with less than 5% of the votes to demand a poll (s 250L(2)).

<sup>454</sup> *McKerlie v Drillsearch Energy Ltd* [2009] NSWSC 488 at [24].

<sup>455</sup> G Stapledon, S Easterbrook, P Bennett and I Ramsay, *Proxy Voting in Australia's Largest Companies* (Centre for Corporate Law and Securities Regulation and Corporate Governance International, 2000) at 16. For instance, only 12% of the sample companies had a poll for director-election resolutions. Also, only 14% of the sample companies that had at least one controversial resolution decided those resolutions on a poll.

<sup>456</sup> Johnson Winter & Slattery, *2011 AGM season survey results*, February 2012.

<sup>457</sup> ACSI Public Statement *Super Fund Expectations: 2012 Voting Season* (23 August 2012).

<sup>458</sup> In *Lion Nathan Limited, in the matter of Lion Nathan Limited (No. 2)* [2009] FCA 1261 at [7]-[15], the Court described an electronic system that was used to check voting entitlements for shareholders at the meeting and to enable them to cast their votes on a poll.

show of hands (representing a majority of shareholders present at the meeting by number only) rather than for a poll to be called where all proxies lodged prior to the meeting are counted together with those present in the room (representing the total number of securities who had cast valid votes for a resolution).<sup>459</sup>

The paper recommended that the Corporations Act be amended to make voting by poll mandatory for listed companies:<sup>460</sup>

Voting by the "show of hands" system excludes proxy votes and gives one vote for each shareholder physically present in the meeting. This results in low transparency and disenfranchises institutional shareholders who cannot typically attend meetings.<sup>461</sup>

### Question

Should any changes be made to the current provisions regarding voting by show of hands?

## 5.14 Independent verification of votes cast on a poll

The integrity of the poll voting system is crucial in ascertaining the will of shareholders, who should be assured that all votes cast on a poll have been properly assessed and counted.

For the purpose of this discussion, votes cast on a poll would involve votes cast by persons physically present at the meeting (in their own right or as proxies), any direct votes cast before the meeting and online votes cast during the meeting.

The *OECD Principles of Corporate Governance* (2004) state that:

As a matter of transparency, procedures for shareholders meetings should ensure that votes are properly counted and recorded, and that a timely announcement of the outcome is made.

A poll may be conducted by written ballot or by electronic means.<sup>462</sup>

Electronic voting systems have been developed, with a view to providing greater certainty that voting instructions have been followed and votes properly recorded.<sup>463</sup>

There is no statutory requirement for independent verification of votes cast at an AGM or other shareholder meeting. Instead, companies may choose to adopt verification procedures such as appointing the company secretary or a share registry to collate the votes (including electronically), with the company's auditor acting as scrutineer. Companies may include certain verification procedures in their constitutions. Any rights given under these constitutional provisions are enforceable by shareholders.<sup>464</sup>

In addition, there is some support at common law for the right of the proposer of a resolution to appoint scrutineers of the poll.<sup>465</sup> Furthermore, the ASX may require a listed entity to appoint the entity's auditor, or another person approved by the ASX, as scrutineer to decide

<sup>459</sup> [Section 9.9.](#)

<sup>460</sup> [Recommendation 6.](#)

<sup>461</sup> [Section 10.6.](#)

<sup>462</sup> *ibid.*

<sup>463</sup> *ibid.*

<sup>464</sup> *Ryan v South Sydney Junior Rugby League Club Ltd* (1974) 3 ACLR 486.

<sup>465</sup> *Industrial Equity v New Redhead Coal Company Limited* [1969] 1 NSW 565.

the validity of votes cast at a general meeting and whether the votes that should have been disregarded were disregarded.<sup>466</sup>

Under the UK legislation, shareholders representing not less than 5% of the total voting rights of all shareholders or not less than 100 shareholders who satisfy certain voting prerequisites may require the directors to obtain an independent report on any poll taken at an AGM.<sup>467</sup> The person appointed by the directors must satisfy a statutory independence test.<sup>468</sup> The report prepared must include an opinion on whether the procedures adopted in connection with the poll or polls were adequate, the votes cast (including proxy votes) were fairly and accurately recorded and counted, and the validity of shareholders' appointments of proxies was fairly assessed. The report must include reasons for the opinions stated.<sup>469</sup>

One commentator has proposed the development in Australia of a fully transparent electronic facility for the processing of proxies (to provide an audit trail in the proxy voting process) and that 5% of shareholders should have the power to appoint an independent party to observe the vote count.<sup>470</sup> [The commentator has also observed that:](#)

[There is also a large element of trust placed in companies to accurately count their own votes. In the vast majority of cases, this confidence is justified. However, in closely contested situations, investors would benefit from the additional transparency that would flow from the ability to appoint an independent scrutineer to oversee or review a poll.](#)<sup>471</sup>

[The ACSI Research Paper \*Institutional Proxy Voting in Australia\* \(October 2012\) commented that that no shareholder has the capacity to initiate an independent review of the votes cast on a poll without making a formal complaint to ASIC after the vote result has been declared.](#)<sup>472</sup> [The paper recommended that the Corporations Act add the equivalent of the UK legislative provisions so that shareholders representing more than 5 percent can appoint an independent assessor to oversee or review a poll.](#)<sup>473</sup>

## Questions

What legislative, or other, verification initiatives, if any, should be introduced concerning voting by poll at an AGM?

Should one or more verification requirements apply in all instances or only if, say, a threshold number of shareholders require it?

<sup>466</sup> ASX Listing Rule 14.8. The person appointed is usually the entity's auditor.

<sup>467</sup> *Companies Act 2006* (UK) s 342. Under the 100 shareholders test, the shareholders must have a right to vote on the matter to which the poll relates and hold shares in the company on which there has been paid up an average sum, per shareholder, of not less than £100. A request may be in hard copy form or in electronic form, must identify the poll or polls to which it relates, must be authenticated by the person or persons making it, and must be received by the company not later than one week after the date on which the poll is taken.

<sup>468</sup> *Companies Act 2006* (UK) ss 343, 344.

<sup>469</sup> *Companies Act 2006* (UK) s 347.

<sup>470</sup> D Paatsch, 'A proxy for shareholder rights reform', *Business Spectator* 27 September 2011.

<sup>471</sup> [D Paatsch and S Connal 'The dark side of proxy voting' \*Business Spectator\* 1 November 2012.](#)

<sup>472</sup> [Section 9.8.](#)

<sup>473</sup> [Section 10.4 and Recommendation 4.](#)

## 5.15 Disclosure of voting after the AGM

### 5.15.1 Disclosure to the market

Listed companies must disclose to the ASX ‘the outcome in respect of each resolution to be put to a meeting of security holders’. The entity must do so immediately after the meeting has been held.<sup>474</sup>

There have been calls from time to time for the development of a template for the market disclosure of voting results. That template could, for instance, in relation to each resolution, require the disclosure of the percentage of the company’s issued capital that was:

- cast on the resolution
- voted in a particular way (for/against/abstain) on that resolution
- voted but treated as invalid (with an explanation, if the voting outcome may have been different if all invalid votes had been counted)
- excluded from voting.

#### Question

Should any steps be taken to promote more consistency in the disclosure to the market of voting results?

### 5.15.2 Access to voting information

In some cases, interested parties may seek immediate access to voting information, particularly if they consider that the announced outcome of a resolution at an AGM may be materially inaccurate.

The CASAC Report recommended that shareholders who between them hold at least 5% of the issued voting shares should be entitled (at their own cost) to inspect the proxy forms, the proxy register and the poll papers in relation to an AGM or other general meeting for 48 hours after the conclusion of that meeting.<sup>475</sup>

This right would allow any potential challenger to the already completed vote to gather evidence of any incorrect rulings on proxies or the validity of votes cast at the meeting.<sup>476</sup>

Other shareholders could obtain access to this information with the leave of the court.<sup>477</sup>

#### Question

Following the AGM, what, if any, rights of access should shareholders generally, or the person proposing a resolution, have to voting documents?

<sup>474</sup> ASX Listing Rule 3.13.2.

<sup>475</sup> para 4.88, rec 16.

<sup>476</sup> para 4.87.

<sup>477</sup> s 247A, taking into account that the definition of ‘books’ of the company in s 9 includes ‘any record of information’.

### 5.15.3 Disclosure in the minutes

All Australian listed companies must prepare and keep minutes of each shareholder meeting, including the AGM.<sup>478</sup> The minutes are available to shareholders.<sup>479</sup>

The minutes must include details of voting on any resolutions decided by a show of hands or on a poll.<sup>480</sup> That information must include proxy voting details. The legislation makes no reference to direct votes before the meeting.

For a resolution decided by show of hands, the minutes must record:

- the total number of proxy votes exercisable by all proxies validly appointed, and
- a breakdown of the total number of proxy votes covered by the proxy appointments in each of four categories, namely total votes directed to be voted for, against and abstaining on a resolution<sup>481</sup> and total votes in respect of which the proxy was given a discretion how to vote.<sup>482</sup>

For a resolution decided on a poll, the minutes must record the same information as for a show of hands, as well as the total number of votes actually cast in each of three categories, namely in favour of, against and abstaining on the resolution.<sup>483</sup>

The CASAC Report recommended that the disclosure requirement for voting by poll should cover only votes actually cast, not the information about directions given by the appointor that is required to be disclosed in relation to voting by show of hands.<sup>484</sup> However, the disclosure in relation to voting by poll should continue to cover abstentions, as:

- it provides more complete information on shareholder voting patterns
- abstention information might be useful for shareholders in some circumstances, though they could not determine from the minutes the reasons why shareholders cast an abstention (in some cases, abstentions are deliberate decisions not to support or oppose a resolution,<sup>485</sup> while in other cases abstentions simply reflect a failure to vote).<sup>486</sup>

#### Question

What, if any, changes should be made to the requirements concerning the recording of details of voting in the minutes of the AGM?

<sup>478</sup> s 251A.

<sup>479</sup> s 251B.

<sup>480</sup> s 251AA.

<sup>481</sup> s 251AA(1)(a)(i)-(iii).

<sup>482</sup> s 251AA(1)(a)(iv).

<sup>483</sup> s 251AA(1)(b).

<sup>484</sup> para 4.86, rec 16.

<sup>485</sup> For instance, assume that a nominee shareholder holds 500,000 shares on behalf of various beneficial owners, on terms that the voting rights attached to those shares are only to be exercised at the express direction of the beneficial owners. That nominee receives, say, directions to vote 'For' a particular resolution from the beneficial owners of 100,000 shares, directions to vote 'Against' that resolution from the beneficial owners of 50,000 shares and no directions at all from the beneficial owners of the remaining 350,000 shares. The nominee, in giving its proxy for its 500,000 shares, say, to the chair, may expressly place those 350,000 shares in the 'Abstention' box, to ensure that they are not available to be exercised at the chair's discretion (given that the chair would not have notice of the terms of the voting arrangements between the nominee shareholder and the beneficial owners).

<sup>486</sup> para 4.86.

### 5.15.4 Record keeping

Maintaining proper voting records, and for a sufficient time, is an essential element in ensuring the overall integrity of voting results.

Currently, there is no standard legislative requirement for the retention of voting records. It depends upon the particular resolutions involved. For instance, voting records concerning related party transactions must be retained for seven years.<sup>487</sup>

On one view, there should be a mandatory minimum period for the retention of voting records on any binding or non-binding resolution voted on at an AGM or other shareholder meeting. In the context of resolutions voted on at an AGM, that minimum period could be at least until some period after the next AGM.

#### Question

Should there be a statutory minimum period for retention of records of voting on resolutions at an AGM and, if so, for what period?

## 5.16 Election of directors

The right of shareholders to elect, as well as remove, directors is fundamental to ensuring managerial accountability. Through the exercise of these election and removal rights, shareholders determine the composition of the board and in this manner influence board decisions and corporate policies. The integrity of the election process for directors is essential for good corporate governance.

### 5.16.1 Current position

All listed companies must hold an election for directors each year, with no director, other than the managing director, having a term in excess of three years (or the third AGM following the director's appointment, whichever is longer) without standing for re-election.<sup>488</sup> There are timing requirements for nominations, including that a listed company must advise the ASX of the date of the AGM at least 5 business days before the closing date for receipt of nominations for election of directors.<sup>489</sup>

Director elections are conducted by separate resolution of shareholders on each candidate for director. Voting on two or more candidates simultaneously (voting on a ticket) is prohibited unless agreed without dissent at the meeting.<sup>490</sup> The board may fill casual vacancies, but persons so appointed must submit themselves for election at the next AGM.<sup>491</sup> The shareholders, by ordinary resolution, may also remove a director at any time.<sup>492</sup>

The ASX Corporate Governance Council *Principles and Recommendations* set out information that companies should provide to shareholders about candidates for election as directors.<sup>493</sup> However, there is no specific statutory right of shareholders to question

<sup>487</sup> s 225(5). See also ss 601LA and 601LE.

<sup>488</sup> ASX Listing Rules 14.4-14.5.

<sup>489</sup> ASX Listing Rule 3.13.1. See also ASX Listing Rule 14.3.

<sup>490</sup> s 201E.

<sup>491</sup> ss 201H, 201P(3), (4).

<sup>492</sup> s 203D. Directors may also be removed by procedures set out in a company's constitution: *Dick v Convergent Telecommunications Ltd* (2000) 34 ACSR 86.

<sup>493</sup> See *Election of directors* under Recommendation 2.4.

candidates, nor is there any obligation on candidates to answer any questions that shareholders might, in effect, ask of them in the context of asking questions on the management of the company.<sup>494</sup>

Under amendments that came into effect in 2011,<sup>495</sup> a public company must obtain the approval of its shareholders in order to declare at a general meeting (either an AGM or an extraordinary general meeting) that there are no vacant board positions, in the case where the number of positions filled on the board is less than the maximum allowable under the company's constitution. If agreed by shareholders, the 'no vacancy' declaration lasts until the following AGM. However, an approved declaration does not prevent the board from appointing a person as a director between general meetings of the company. These provisions have effect despite anything in the company's constitution.

### 5.16.2 Frequency of election

Under the ASX Listing Rules, the maximum term for a director, other than the managing director, is three years. Directors may stand for re-election.<sup>496</sup>

By contrast, annual election of all directors of FTSE 350 companies is set out as best practice under the UK Corporate Governance Code,<sup>497</sup> with indications that most of these companies have adopted annual elections.<sup>498</sup> [There are also initiatives by some US institutional shareholders to encourage various S&P 500 and Fortune 500 public companies that provide for staggered election of directors to move to annual election of directors.](#)<sup>499</sup>

[The Toronto Stock Exchange has introduced annual election of directors.](#)<sup>500</sup>

Any move in Australia towards annual election of directors may have significant implications for board accountability, as directors would have to justify their position each year. It would also have implications for the two-strikes rule concerning the remuneration report, as annual elections for all directors, in effect, constitutes an annual spill of the board.

### 5.16.3 Method of election

There is no standard prescribed method for conducting the election of directors. Companies have a wide discretion to determine the procedure.

#### *CASAC principles*

The CASAC Report recommended the introduction of two principles to govern any procedure for the election of directors to ensure its fairness, particularly where there is a contest for board positions, to avoid an incumbent board seeking to use the voting procedure to 'cherry pick' the directors to be appointed:

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<sup>494</sup> s 250S.

<sup>495</sup> ss 201N-201U. Notice of intention to obtain shareholder approval to declare that there are no vacant board positions, along with an explanatory statement, must be given to shareholders as part of the notice convening the meeting. The notice must specify the board limit that is being agreed upon. The explanatory statement must set out the board's reasons for proposing the resolution and information to assist shareholders to determine whether the proposed resolution is in the company's interests.

<sup>496</sup> ASX Listing Rules 14.4-14.5.

<sup>497</sup> Code Provisions B.7.1.

<sup>498</sup> The FRC report *Developments in Corporate Governance 2011: The impact and implementation of the UK Corporate Governance and Stewardship Codes* (December 2011) notes that 80% of FTSE 350 companies have adopted annual re-election of all directors.

<sup>499</sup> [Shareholder Rights Project New Alert 28 November 2012.](#)

<sup>500</sup> [News Release 'Toronto Stock Exchange to strengthen corporate governance requirements for listed issuers' 4 October 2012.](#)

- *equal opportunity principle*: all candidates in an election where there are more candidates than vacancies should have an equal opportunity to be elected
- *majority vote principle*: a candidate in any election, whether or not there are more candidates than vacancies, should only be elected if that person receives more votes for than against him or her.

The equal opportunity principle seeks to deal with the situation where there are more candidates than available positions. Shareholders might be asked to elect directors under a sequential voting system whereby they vote on each candidate in the order chosen by the company's directors, but only until all vacant positions have been filled. This could result in the election being completed before some candidates placed lower in the order have been reached. This method of voting where there are more candidates for director than vacant positions would not be permitted under the equal opportunity principle, which would require that a vote be taken on all candidates.<sup>501</sup>

The majority vote principle requires that shareholders have a clear right to elect as directors as many or as few candidates as they choose, though no more than the number of available board positions. Shareholders should not be compelled to fill all available board positions, even in uncontested director elections where there are no more candidates than vacant board positions. They should have the option to leave any or all of the board positions vacant, by being able to vote against particular candidates. The right of shareholders to decide that not every vacancy should be filled differs, for instance, from Parliamentary elections where all seats are filled.

### *Industry guidance*

Various voting systems could be devised consistent with both principles. For instance, one 'best practice' recommended approach is a vote by poll on each of the candidates respectively, with shareholders voting for or against as few or as many candidates as they wish, and with voting by poll on each candidate to be completed before any result of the voting is announced. Only those candidates who had received more 'for' than 'against' votes would then be considered for election. Where the number of remaining candidates is equal to or fewer than the number of available board places, those candidates would be deemed elected as directors (with board positions remaining vacant to the extent that there were fewer remaining candidates). Where the number of remaining candidates exceeds the number of available board places, the candidates would be ranked according to the relative number of 'for' votes, with board positions filled from the top down according to the number

<sup>501</sup> In *Brettingham-Moore v Christie* (Supreme Court of Tasmania, 21 November 1969, per Neasey J), there were five candidates for three board positions. A sequential system of election was adopted, whereby the first three candidates were placed before the meeting one by one, and each was elected by separate majority vote. The chairman then declared that the election was complete, given that all board positions had been filled, notwithstanding that the meeting had not voted on the remaining two candidates. Subsequently at the meeting, the chairman accepted a motion that the election of the first three candidates be declared null and void and that a ballot be taken. That motion was put to a vote and lost. Neasey J held that in these circumstances the first three candidates had been validly elected. However, the Court's ruling depended on the effect of the vote on the motion. According to His Honour: 'I think the *result of the motion* must be accepted as a decision by a majority of the meeting in favour of those three persons being declared as directors, to the exclusion of the other two' (italics added). Neasey J therefore interpreted the final motion as a decision by the meeting on the last two candidates who had not been earlier considered by the meeting.

This case does not support a sequential system of electing directors whereby certain candidates are not considered at all for election, because all board positions have been filled before they are reached. Rather, the case supports the proposition that if there are more candidates than vacancies, a system must be employed which ensures that all candidates, in some manner, come before the meeting for determination so that the true will of the majority can be ascertained in respect of the field of candidates as a whole.

of available positions. If there are candidates with equal number of ‘for’ votes, then a candidate with fewer ‘against’ votes will be ranked higher.<sup>502</sup>

This approach would ensure that each candidate has an equal opportunity to be elected and that any candidate who is elected, including in uncontested director elections, has the support of the majority of votes cast in relation to him or her. It could result, however, in some candidates with majority support on their individual poll not being elected, depending upon the number of available board positions.

### [Canadian initiative on majority vote principle](#)

[In October 2012, the Toronto Stock Exchange \(TSX\) announced amendments to Part IV of the TSX Company Manual that relate to how a listed issuer elects its board of directors.](#)<sup>503</sup>  
[The new rules, operative from 31 December 2012, include a requirement for listed issuers:](#)

- [to disclose if they have adopted a majority voting policy for each director in uncontested director elections \(in effect, requiring that each candidate receive a majority of votes cast for him or her even where there are no more candidates than vacant board position\), and](#)
- [where a majority voting policy has not been adopted, to disclose whether each director appointed in uncontested director elections would have received a majority of votes if a vote had been held.](#)

[The TSX also announced that it is seeking comment on additional proposed amendments to the TSX Company Manual that would require issuers to have majority voting for uncontested director elections.](#)

[This contrasts with the US position, where a recent study reveals that few directors in uncontested director elections fail to be appointed, even when they lack shareholder support. This is principally because many smaller and mid-sized US listed companies do not have a majority voting standard for director elections, in effect, permitting boards to ignore the wishes of shareholders in uncontested elections.](#)<sup>504</sup>

### **Cumulative voting**

Another possible method for electing directors involves cumulative voting, whereby shareholders may vote their shares multiple times, up to the number of board vacancies to be filled.

Under one form of cumulative voting, shareholders could cast all their multiple votes for a single candidate or apportion them among different candidates in any manner. The CASAC Report noted that:

The greater the number of vacancies, the higher the possibility of minority shareholders securing some representation by focusing their multiple votes on the same one or few candidates. By contrast, under non-cumulative voting, a majority shareholder, or a majority group of shareholders, could determine all positions on the board.<sup>505</sup>

<sup>502</sup> CSA *Guide to Procedures at AGMs* at 3.

<sup>503</sup> News Release ‘Toronto Stock Exchange to strengthen corporate governance requirements for listed issuers’ 4 October 2012.

<sup>504</sup> GMI Ratings and IRRIC Institute, *The election of corporate directors: what happens when shareholders withhold a majority of votes from director nominees* (August 2012).

<sup>505</sup> Para 4.198.

Cumulative voting is not prohibited under the Corporations legislation, but may require Exchange approval, given the current ASX Listing Rule of one vote per share.<sup>506</sup>

### Question

Should there be any legislative initiatives in regard to the election of directors, including in relation to:

- the frequency with which directors should stand for re-election
- the right of shareholders to question candidates (and receive answers)
- the voting procedure?

## 5.17 Dual listed companies

The dual listed companies structure involves two companies being operated and managed as if they were a single economic entity, through a shareholder approved agreement. The two companies retain separate legal identities and stock exchange listings and have separate annual general meetings. Both Rio Tinto Group and BHP Billiton have a dual listed company structure and both have dual listings on the ASX and on the London Stock Exchange.

Where two companies function as a single economic entity, the meeting voting procedures have to be adjusted to allow for the effective integration of shareholder voting at each respective AGM.

For instance, the BHP Billiton dual listed companies structure allows shareholders of BHP Billiton Limited (Limited) (listed in Australia) and BHP Billiton Plc (Plc) (listed in the UK) to make joint decisions on matters that affect the shareholders of each company in similar ways. All items of business at the AGMs of Limited and Plc are joint electorate actions, with all resolutions at those separate AGMs decided by poll. The results for the Plc and Limited meetings are identical. That is, the final Plc meeting outcome is the shareholder voting outcome at the Plc AGM plus the voting outcome of the Limited AGM (lodged via a Special Voting Share). The same is true for Limited, where the votes cast at the BHP Billiton Plc AGM are treated as though they were also cast at the Limited AGM, and are therefore added to achieve the final voting outcome.

At the Plc meeting (which occurs first), the poll remains open for sufficient time to allow the Limited meeting to be held and for the votes to be ascertained and cast. Because of the dual listed company structure, the results of each resolution cannot be finalised until both meetings are concluded.<sup>507</sup>

### Question

Are there any matters concerning dual-listing that should be taken into account in the regulation of AGMs?

<sup>506</sup> ASX Listing Rule 6.9.

<sup>507</sup> This voting system is further explained in the BHP Billiton Limited *Notice of meeting* 2011 at 9-10.

## 5.18 Globalisation

The *OECD Principles of Corporate Governance* (2004), which provide general guidance on corporate matters globally, state that:

The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders.<sup>508</sup>

A subpart of this principle is that:

Impediments to cross border voting should be eliminated.<sup>509</sup>

The OECD's annotation to this part of the principle states:

Foreign investors often hold their shares through chains of intermediaries. Shares are typically held in accounts with securities intermediaries, that in turn hold accounts with other intermediaries and central securities depositories in other jurisdictions, while the listed company resides in a third country. Such cross-border chains cause special challenges with respect to determining the entitlement of foreign investors to use their voting rights, and the process of communicating with such investors. In combination with business practices which provide only a very short notice period, shareholders are often left with only very limited time to react to a convening notice by the company and to make informed decisions concerning items for decision. This makes cross border voting difficult. The legal and regulatory framework should clarify who is entitled to control the voting rights in cross border situations and where necessary to simplify the depository chain. Moreover, notice periods should ensure that foreign investors in effect have similar opportunities to exercise their ownership functions as domestic investors. To further facilitate voting by foreign investors, laws, regulations and corporate practices should allow participation through means which make use of modern technology.

Another subpart of this principle is that:

Processes and procedures for general shareholder meetings should allow for equitable treatment of all shareholders. Company procedures should not make it unduly difficult or expensive to cast votes.<sup>510</sup>

The OECD's annotation to this subpart of the principle states:

The right to participate in general shareholder meetings is a fundamental shareholder right. Management and controlling investors have at times sought to discourage non-controlling or foreign investors from trying to influence the direction of the company. Some companies have charged fees for voting. Other impediments included prohibitions on proxy voting and the requirement of personal attendance at general shareholder meetings to vote. Still other procedures may make it practically impossible to exercise ownership rights. Proxy materials may be sent too close to the time of general shareholder meetings to allow investors adequate time for reflection and consultation. Many companies in OECD countries are seeking to develop better channels of communication and decision-making with shareholders. Efforts by companies to remove artificial barriers to participation in general meetings are encouraged and the corporate governance framework should facilitate the use of electronic voting in absentia.

In Australia, use is often made of custodial arrangements whereby the custodian holds shares or other interests on behalf of underlying holders, including those located overseas. As the nominee company of the custodian will be the person entered as holder on the register, it

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<sup>508</sup> Principle III.

<sup>509</sup> Principle III.A.4.

<sup>510</sup> Principle III.A.5.

will receive the notice of meeting and be responsible for notifying underlying holders of the upcoming shareholder meeting. If the underlying holder wishes to vote, the custodian must execute the vote.

**Question**

Are there any problems in the voting or other aspects of AGMs for overseas holders of shareholding interests in Australian regulated companies?

## 6 Future of the AGM

*This chapter raises broad considerations about the future role of the AGM and its possible format, as part of Issue 3 of the paper.*

### 6.1 Overview

Historically, the concept of an AGM developed when the only means for shareholders to interact and discuss issues relevant to their company was through a physical meeting at a designated location. Detailed statutory and other mechanisms have developed to regulate the ambit and conduct of the AGM, as set out in Chapter 5.

However, given the size of many public companies today, the advent of electronic communications and the introduction of continuous disclosure requirements, the AGM is now only one means of informing and engaging with shareholders. The future role of the AGM as a shareholder engagement forum is coming under scrutiny, with questions being raised:

- whether the functions of the AGM might usefully be changed in some manner, or the obligation to hold an AGM be abolished, for some or all public companies
- whether greater flexibility could be introduced concerning the format of the AGM (if retained), for some or all public companies.

### 6.2 Functions of the AGM

#### 6.2.1 Overview

The AGM is the only shareholder meeting that public companies are obliged to hold.<sup>511</sup>

On one view, the AGM is not just a compliance exercise, but (together with other forms of dialogue with shareholders) is a means of achieving informational and governance goals that are also integral to a company's investor relations activities, for retail as well as institutional shareholders.

For instance, it has been observed that, while institutional shareholders do not rely on the AGM as their primary forum for engagement with companies, nevertheless:

The AGM provides shareholders, particularly retail shareholders, with the opportunity to make an assessment of the chairman and the directors of the companies in which they invest. Indeed, for many shareholders, it is the only opportunity they have to see and hear directors personally. Accordingly, both directors and shareholders perceive that

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<sup>511</sup> Other general meetings may be called by the company for various reasons, including to obtain shareholder approval for certain transactions (for instance, related party transactions, members' schemes of arrangement or share acquisitions that otherwise would breach the takeover provisions). Shareholders who satisfy the stipulated threshold can also requisition or call a general meeting: ss 249D-249F. The court may also order a shareholders' meeting if it is impracticable to call the meeting in any other way: s 249G (see, for instance, *Beck v Tuckey Pty Ltd* [2004] NSWSC 357).

the AGM can be a powerful motivator and influencer of a company's approach to governance.<sup>512</sup>

Also:

The AGM has been described as a means of demonstrating respect for the retail owners of the company or those owners of the company with small holdings.<sup>513</sup>

It has also been observed that the AGM:

keeps boards mindful of their accountability to shareholders and the need for transparency in the execution of their responsibilities.<sup>514</sup>

On the other hand, questions have been raised about whether the AGM, at least in its current form, continues to serve the purposes for which it was originally designed, or any other worthwhile purposes. Debate on whether changes should be made to the functions of the AGM, or whether the obligation to hold an AGM could be dispensed with altogether, has been developing for some time. These calls for review have gathered momentum with the rise of institutional share ownership, developments in electronic communications and consequent greater access to information for all shareholders, and relatively low attendance rates at AGMs.

In its current form, the AGM may be described as having four principal functions:

- *a reporting function*, covering reporting to shareholders on various matters
- *a questioning function*, covering the right of shareholders to ask questions and make comments on the management of the company
- *a deliberative function*, covering the discussion of matters on which shareholders may vote (in binding or non-binding resolutions), and
- *a decision-making function*, covering the process and outcome of voting on resolutions.<sup>515</sup>

The issue is whether these functions should continue to be combined in the AGM, whether the AGM should perform only some of these functions, or whether the obligation to hold an AGM should be dispensed with.

### 6.2.2 Options for change

There are various options that can be devised as to the future role and functions of the AGM, including those set out below. Views may differ on the relative merits of these options. For instance, a survey in 2012 by Allens Linklaters of its listed clients<sup>516</sup> revealed a variety of views on whether the AGM should be redesigned in some manner or be abolished.<sup>517</sup> Amongst respondents who supported reform of the AGM, 'there was no clear consensus as to a preferred alternative to the AGM structure'.<sup>518</sup>

<sup>512</sup> CSA/Blake Dawson (now Ashurst Australia) discussion paper *Rethinking the AGM* (2008) Section 2.2.

<sup>513</sup> *ibid.*

<sup>514</sup> J Stafford, *Engaging with shareholders* (AICD) 2011 at 83.

<sup>515</sup> See further Section 2.4.2 of this paper.

<sup>516</sup> The respondents comprised board chairs, non-executive directors, chief executive officers/chief financial officers, General and Legal Counsel and Company Secretaries of various large, mid and small cap listed companies.

<sup>517</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 4-7.

<sup>518</sup> *id.* at 1.

***Option 1: limit the AGM to the deliberative and decision-making functions***

Under this approach the AGM would be restricted to discussion of, and voting on, the remuneration report, the election of directors, and other resolutions on the agenda of the AGM.

Confining an AGM in this way may need to be counterbalanced by the introduction of statutory provisions, or best practice guidelines, concerning alternative means of ensuring appropriate reporting to shareholders and safeguarding their questioning rights. This might include procedures for web-based corporate briefings (in addition to circulation of the annual report) and a capacity for shareholders to question the directors and management on an ongoing basis, with, say, questions and answers being published on the company's website.

On one view, a right of shareholders to ask questions, or make comments, on the management of a company on a continuing basis may be more effective than the current right of shareholders to do so at the AGM.<sup>519</sup> Questions or comments at the AGM can be too late to influence the outcome of shareholder voting on resolutions, as proxy votes, which may well decide the matter, have already been cast.

***Option 2: separate out the decision-making function of the AGM***

Under this approach, the reporting, questioning, and deliberative functions of the AGM would remain, but without the need for the decision-making function of the AGM to be completed at the same time as the meeting.

The CSA/Blake Dawson (now Ashurst Australia) discussion paper *Rethinking the AGM* (2008) proposed decoupling the decision-making function of the AGM through post-meeting voting. This change:

would enable shareholders, particularly retail shareholders, to have the opportunity, even if they are physically unable to attend the meeting, to reflect on the questions posed at the AGM, the directors' responses to those questions and any other issues that were raised on the day, prior to voting ... shareholders could exercise their right to vote, having had the benefit of reflection on the information discussed at the general meeting. Their decision-making would be fully informed, and would not be dependent on whether they could or could not physically attend the meeting.<sup>520</sup>

The paper suggested that voting could stay open for a set period after the close of the AGM, thereby providing shareholders with the opportunity to exchange information without the pressure to bring proceedings to a vote during or by the end of the meeting, and to consider the information raised at the AGM before voting.

Under the procedure proposed in the paper:

- polls on each resolution would open at the start of the AGM and stay open for a set period after the close of the meeting (48 hours/one week/two weeks<sup>521</sup>)

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<sup>519</sup> s 250S.

<sup>520</sup> Section 4.1.

<sup>521</sup> Section 4.1 discusses the relative merits of these time options.

- The advantage of a 48 hour period is that the formal process of decision making would not be extended greatly beyond the reporting and deliberative aspects of the meeting, so that shareholders would have the opportunity to exercise their voting rights quickly once they have reflected on the discussion at the meeting.
- On the other hand, a one or two week period might be necessary to accommodate the process of seeking investor direction from beneficial owners via nominees and custodians as well as from registered holders. Australian custodians have to seek voting instructions from investors globally.

- shareholders could vote
  - at any time during the meeting, or
  - at the close of the meeting, or
  - after the meeting, as long as their vote is received by the stipulated closing date for voting
- absent shareholders could still appoint proxies to attend the meeting to listen to the discussion, and to vote on their behalf at the meeting, but if a shareholder decides to lodge a subsequent direct vote after the meeting, that vote would override the earlier vote cast by the proxy on behalf of the shareholder.<sup>522</sup>

The paper suggested that separating out the decision-making function of the AGM could be mandated in the legislation or alternatively be a best practice recommendation in the ASX Corporate Governance Council *Principles and Recommendations*.<sup>523</sup>

The PJC report *Better shareholders – Better company* (June 2008) recommended further consultation with industry on this possible form of voting.<sup>524</sup>

Previously, the CASAC Report considered various possible forms of post-meeting voting:

- *permit further voting after the meeting*: under this approach, shareholders would have the choice to vote within a set time (say, two weeks) after the close of the meeting. The option of postponed voting would give shareholders a further opportunity to consider all information, including that provided at the meeting, before casting their vote.<sup>525</sup>
- *require all voting to take place after the meeting*: under this approach, the business of the AGM would be confined to its reporting, questioning and deliberative functions. Voting on resolutions on the agenda of the AGM could only take place within a stipulated time after the close of the meeting.<sup>526</sup>

Arguments set out in the CASAC Report for permitting or requiring post-meeting voting included:

- contentious issues cannot always be resolved at meetings. It is more important to achieve the right result eventually rather than a lesser quality result by the conclusion of the meeting
- the best time to vote is when shareholders have been fully briefed after they have received the annual report and the AGM has provided an opportunity for verbal communication between directors and shareholders.<sup>527</sup>

Arguments set out in the CASAC Report against permitting or requiring post-meeting voting included:

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<sup>522</sup> Section 4.1.a.

<sup>523</sup> Section 4.1.c.

<sup>524</sup> rec 18.

<sup>525</sup> para 4.146.

<sup>526</sup> para 4.147.

<sup>527</sup> CASAC Report para 4.148.

- given the statutory requirements for adequate notice of meetings, there is no reason why voting should not occur prior to or at the meeting
- if post-meeting voting is permitted, directors or shareholders could put considerable pressure on those shareholders who have not yet cast their vote, in an attempt to change the result based on votes cast by the end of the meeting
- there is a need for finality of outcome at shareholder meetings rather than delay in announcing the results of resolutions to the market.<sup>528</sup>

The CASAC Report did not recommend post-meeting voting, taking the view that:

- it is important that meetings achieve a final outcome, without further delay
- to permit postponed voting may mean that shareholders must rely on a follow-up announcement to find out what decisions have been made.<sup>529</sup>

### ***Option 3: some other adjustment to the current functions of the AGM***

The AGM requirements apply equally to all public companies, whether listed or unlisted, and whether engaged in entrepreneurial or other activities.

It has been suggested from time to time that this ‘one size fits all’ approach to the AGM should be replaced with a more flexible system that recognises that the relevance and purpose of the AGM are likely to differ among companies.

For instance, a survey in 2012 by Allens Linklaters of its listed clients<sup>530</sup> noted that survey respondents suggested that the relevance of the AGM may vary from one company to the next according to such factors as:

- the size of the company
- whether or not the company is listed
- the shareholder base of the company
- whether or not the company is going through a period of major change.<sup>531</sup>

Matters that would need to be resolved in any move to have a more flexible approach of this nature would include how the various functions of the AGM might be adjusted for different types of companies, and whether any adjustments would be a matter for particular companies to determine or be externally regulated in some manner.

### ***Option 4: abolish the requirement for an AGM***

Under this option, it would be a matter for each company to decide whether to hold an AGM.

The Business Council of Australia, some years ago, observed that:

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<sup>528</sup> CASAC Report para 4.149.

<sup>529</sup> para 4.150, rec 24.

<sup>530</sup> The respondents comprised board chairs, non-executive directors, chief executive officers/chief financial officers, General and Legal Counsel and Company Secretaries of various large, mid and small cap listed companies.

<sup>531</sup> Allens Linklaters, *Allens Listed Client Survey CAMAC Review of Annual General Meetings* (2012) at 7.

Most resolutions at AGMs are also determined by proxy votes and with moves to encourage more voting by institutional investors, this is likely to increase. Resolutions are therefore determined without the need for a physical meeting. If AGMs were to be abolished, resolutions could still be put to shareholders in writing, with shareholders voting in writing or through some electronic form (for example, via the Internet). This would not be greatly different to current practice where the text of resolutions is sent out to shareholders with the AGM notice of meeting and shareholders may vote by returning their proxy forms directing their proxy how to vote on a resolution.<sup>532</sup>

In weighing the worth of the AGM, it is also important to determine how the current reporting, questioning and deliberative functions of that meeting could otherwise be achieved.

On one view, the reporting function of the AGM could be achieved without the need for shareholders to assemble at the AGM or any other physical meeting. For instance, in addition to continuous disclosure announcements and other information releases on the company's website, further background information could be made available in the annual report distributed to shareholders. Questions and comments by shareholders, and responses from the company, could be disseminated by other means of communication, such as posting on the company's website. However, dispensing with the obligation to hold an AGM may need to be counterbalanced by statutory provisions, or best practice guidelines, concerning the communicative rights of shareholders.

In regard to the deliberative function, a traditional argument for requiring a physical meeting of shareholders is that it provides an opportunity for them to discuss proposed resolutions before the vote is taken. However, in practice, the outcomes of voting on many resolutions put at the AGM may already have been determined by pre-meeting proxy voting.

In regard to the decision-making function, any move towards resolutions otherwise coming before an AGM being determined without the need for an AGM raises questions about the other circumstances where shareholder approval is required (for instance, related party transactions<sup>533</sup> and members' schemes of arrangement<sup>534</sup>) and whether the need for a physical meeting of shareholders in those circumstances could also be dispensed with.

### Questions

For some or all public companies, should the functions of the AGM be changed in some manner, or the obligation to hold an AGM be abolished?

In this context, what technological developments might be taken into account in considering the possible functions of the AGM?

## 6.3 Format of the AGM

If the AGM is retained in some manner, questions arise as to whether companies should have greater choice as to the format for conducting the meeting.

<sup>532</sup> Business Council of Australia Discussion Paper *Company + Shareholder Dialogue: Fresh approaches to communication between companies and their shareholders* (2004) at 24.

<sup>533</sup> Chapter 2E of the Corporations Act.

<sup>534</sup> Part 5.1 of the Corporations Act.

### 6.3.1 Current position

Currently, an AGM must be held at a designated location, with shareholders entitled to attend in person and participate in the meeting (physical meeting). A company may hold a meeting at two or more venues using any technology that gives the shareholders as a whole a reasonable opportunity to participate.<sup>535</sup>

Companies may also choose to webcast the physical meeting to allow absentee shareholders (who may have appointed proxies to attend the meeting and vote on their behalf) to observe the proceedings through the Internet. On one view, shareholders would benefit if webcasting became a standard practice, say through a Listing Rule or best practice guide.

Webcasting a physical meeting, while beneficial, may not suffice. Shareholders who are not attending a physical meeting may also need some means directly to participate and vote at the meeting.

### 6.3.2 Options for change

Technological developments open up the possibility of one or more other formats being employed for conducting an AGM, including those set out below.

The alternative formats for conducting an AGM that might be suitable will also be influenced by any change to the current functions of the AGM.

While Option 1 could possibly be employed by companies under the current legislative provisions, any of the other options would most likely require legislative support to make them available to companies.

#### Option 1: Hybrid physical-online meeting

##### General considerations

One means to improve participation levels at AGMs may be to go beyond shareholders being able to observe a physical meeting through webcasting, and offer them the option of online participation and voting at that meeting.

In some overseas jurisdictions, including Delaware in the United States, companies may permit shareholders to participate and vote at an AGM (or other shareholder meeting) through electronic means, employing the Internet.<sup>536</sup>

A threshold question is whether legislative amendment is necessary to permit online shareholder participation and voting at a physical meeting. One view is that a legislative amendment may not be necessary, but could be beneficial:

We have a provision in our *Corporations Act 2001* (Cth) (section 249S) that permits meetings to be held at two or more ‘venues’ using any technology that gives the members as a whole reasonable opportunity to participate. But that section probably does not envisage online participation through the internet – rather, it has in mind a

<sup>535</sup> s 249S.

<sup>536</sup> Delaware’s General Corporation Law Section 211 provides that a corporation’s board of directors alone may establish procedures for an online shareholders meeting provided that (1) stockholders can participate, and (2) such stockholders can be verified as present and voting at such meeting. See further L Fairfax, ‘Virtual shareholder meetings reconsidered’ (2010) 40 *Seton Hall Law Review* 1367. See also the Canada Business Corporations Act s 141.

meeting at several venues, linked by audio-visual facilities. In fact, there is nothing in the *Corporations Act* itself that expressly permits online participation.

Another law may help. The *Acts Interpretation Act 1901* (Cth) ... is expressly made to apply to the *Corporations Act* (see section 5C(2)). Section 33B of the *Acts Interpretation Act* states that where a body is established by an Act and the Act requires or permits meetings of its members, then the body may permit its members to participate in a meeting, or all meetings, by telephone or closed-circuit television or 'any other means of communication'. A member who participates in that fashion is then taken to be present at the meeting.

While s 33B seems on its face to permit online participation at a shareholders' meeting, there is room for argument as to whether it applies in the corporate context. A specific legislative amendment to permit online participation would put the matter beyond doubt. However, the present law [s 249S] seems not to present any obstacle to online participation, whether section 33B can be relied upon or not, provided that there is clear authorisation in the corporate constitution.<sup>537</sup>

If the current functions of the AGM are retained, it would be necessary to ensure that the accountability of management to shareholders is also maintained, including giving shareholders participating online a reasonable opportunity to ask questions about, or make comments on, the management of the company, as well as being involved in the deliberation on matters for determination at the meeting.<sup>538</sup> Also, shareholders participating online would need a capacity to vote on resolutions as they arise for determination (see also Section 5.11).

Various other implementation issues arise that may need to be dealt with either in legislation or in the company's constitution, including the consequences for conducting and voting at the meeting of any technological failure during the course of the meeting.<sup>539</sup>

### Turkish initiative

In October 2012, Turkey became the first country to require its listed companies to offer shareholders the choice of physical or electronic participation and voting at the annual, and other, general meetings of shareholders. Shareholders may choose to participate online, using an electronic general meeting system called e-GEM, which is overseen by a division of the Istanbul exchange (MKK). Audiovisual transmission of shareholder meetings through e-GEM is obligatory for listed companies, whether or not shareholders attend by this means.<sup>540</sup>

The e-GEM system operates prior to, during and after the shareholder meeting.

### Prior to the meeting

<sup>537</sup> Minter Ellison, *Online participation in shareholder meetings – how could it work?* Corporate HQ Advisory Newsletter, September 2011.

<sup>538</sup> These issues are further discussed in E Boros, 'Corporate governance in cyberspace: who stands to gain what from the virtual meeting?' *Journal of Corporate Law Studies* Vol 3 Part 1 (2003) at 149 and E Boros, 'Virtual Shareholder Meetings: Who Decides How Companies Make Decisions?' (2004) 28 *Melbourne University Law Review* 265.

<sup>539</sup> Various implementation issues are outlined in Minter Ellison, *Online participation in shareholder meetings – how could it work?* Corporate HQ Advisory Newsletter, September 2011. The view taken in that article is that the matters could be dealt with by appropriate constitutional amendment.

<sup>540</sup> Turkish Commercial Code Article 1527, together with 'The Regulation on attendance at general assembly meetings of joint stock companies by electronic means' (Issue 28395 of the *Official Gazette*, 28 August 2012) and 'The Communiqué on electronic general meeting system applicable at general assemblies of joint stock companies' (Issue 28396 of the *Official Gazette*, 29 August 2012), which became effective on 1 October 2012. See also, MKK (Central Registry Agency Inc.) General Letter No. 604 (31 August 2012).

The e-GEM system allows registered shareholders to be notified electronically when a notice of a shareholder meeting is published by the company on e-GEM. Companies will be required to lodge meeting documents on e-GEM. Those documents will be accessible to shareholders. Shareholders can appoint a proxy electronically and give any voting instructions to the appointee electronically. Alternatively, shareholders can vote directly before the meeting.

#### At the meeting

The e-GEM system will stream shareholder meetings in real time. It will allow shareholders, through use of an electronic signature, to watch the meeting online, ask questions, express opinions, communicate with each other and vote online, simultaneously with the physical meeting. Shareholders who voted electronically prior to a meeting can change those votes electronically during the meeting. Shareholders will also have electronic access to voting results.

The e-GEM system also allows shareholders electronically to attend a number of shareholder meetings concurrently.

#### After the meeting

MKK will maintain an electronic archive of each shareholder meeting, covering the meeting documents, an audio-visual record of the meeting, and voting results.

### **Option 2: Online-only meeting**

Another approach is to permit companies to dispense altogether with the physical or hybrid AGM, and conduct online-only AGMs. Under this approach, the chair and other corporate representatives would be ‘live’ at one or more locations, but with all proceedings conducted online and with no opportunity for shareholders to be physically present at any of those locations.

An online-only meeting would be economical. Even with the cost of technology services, it would be only a fraction of the cost of a physical meeting. However, if the current functions of the AGM are retained, fundamental issues about shareholder participation rights and management accountability would arise, including whether this format for the meeting would sufficiently substitute for the face-to-face accountability of management to shareholders offered by the physical meeting. There would also continue to be a problem for shareholders who do not have online access to the meeting.

### **Option 3: Virtual meeting**

Another possibility is to go beyond the online-only meeting and permit a company to dispense with any requirement for the chair and other corporate representatives to be present or ‘live’ at any location. The meeting could be conducted solely through electronic presentations, discussions and voting procedures, according to an agenda timetable published and operated electronically.

Under this approach, the various presentations from company officers could be pre-recorded and be posted on the company website at the stipulated time under the agenda timetable. Shareholders could be given a designated period under the agenda timetable to ask questions, make comments or discuss proposed resolutions through the Internet, with any responses or comments from corporate officers being published in electronic written form. Voting on resolutions under the agenda timetable could employ the same voting

mechanisms as presently permitted,<sup>541</sup> except that proxies would vote electronically. Provision could be made for post-meeting voting, if this method of voting was permitted and was adopted.

The same types of issues would arise as with online meetings, possibly even more accentuated by dispensing with any requirement for the chair or other corporate officers to be ‘live’ during the meeting.

### **Questions**

For some or all public companies, and if the AGM is retained in some manner, what legislative or other initiatives, if any, should there be in regard to the possible formats of the AGM?

In this context, what technological developments might be taken into account in considering possible formats for the AGM?

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<sup>541</sup> See Sections 5.8, 5.9 and 5.11 of this paper.